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Mergers, MACs, and COVID-19

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SYMPOSIUM FEATURE

MERGERS, MACS, AND COVID-19

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The conventional wisdom is that MAE/MACs in merger agreements provide an opportunity for buyers to renegotiate merger agreements in the event of intervening adverse events. However, the experience following the COVID-19 outbreak suggests that the conventional wisdom is incorrect or at least overstated. In fact, MAE/MACs shift the risk of exogenous adverse events (like COVID-19) to buyers while leaving only the risks of adverse endogenous and semi-endogenous events with the seller. The consequence of this risk-shifting is to strictly limit the circumstances under which a buyer can credibly lean on a MAE/MAC to threaten to terminate a merger agreement and initiate a renegotiation. Parties to merger agreements appear to have internalized that lesson, as demonstrated by the relative paucity of renegotiations in the immediate aftermath of the COVID-19 outbreak.

INTRODUCTION

On May 20, 2020, Forescout Technologies filed a lawsuit seeking a declaratory judgment against Advent International.[1] Forescout and Advent had signed a merger agreement in early February, some three months before.[2] By May, it was becoming apparent to

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1. Press Release, Forescout, Forescout Commences Litigation Against Advent International (May 20, 2020, 8:00 AM ET) [hereinafter Press Release, Forescout Litigation], https://www.globenewswire.com/news-release/2020/05/20/2036337/0/en/Forescout-Commences-Litigation-Against-Advent-International.html [https://perma.cc/5GCT-KQFR].

2. *Id.*

Forescout that Advent was suffering buyer's remorse: a deal that looked good prior to the onset of a global pandemic looked less wonderful after the U.S. economy ground to a halt in an effort to battle the spread of COVID-19. Forescout's lawsuit sought a declaratory judgment from the court that COVID-19 did not represent a material adverse event and an order that Advent proceed to closing of the transaction.[3] Ultimately, Forescout and Advent settled the litigation through a renegotiation downwards of the merger price and the transaction moved forward to closing.[4] The Forescout litigation was one of a small number of cases that followed the onset of COVID-19 in the spring of 2020 in which buyers sought to walk away from merger agreements citing a material adverse effect.[5] While the Forescout story is consistent at first glance with the conventional wisdom that parties use material adverse effect/material adverse change ("MAE/MAC") clauses in merger agreements to facilitate renegotiation, the paucity of such efforts following the COVID-19 outbreak should cause us to re-evaluate that conventional wisdom.[6] This Article argues that the ambiguity that often serves the corporation law well has, by now, dissipated with respect to MAE/MAC clauses, and there has been a fundamental change in the role of the MAE/MAC since 2001. The lack of ambiguity surrounding modern MAE/MAC clauses has, as a result, fundamentally changed the role MAE/MAC clauses play in merger agreements. Rather than act as a quasi-force majeure clause, with the seller bearing the burden of adverse shock, modern MAE/MAC clauses allocate exogenous risks to the buyer and endogenous risks to the seller consistent with the role described by Professors Gilson and Schwartz.[7] Consequently, conventional wisdom that describes

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3. *Id.*

4. Press Release, Forescout, Forescout and Advent International Reach Amended Merger Agreement (July 15, 2020, 9:00 AM ET) [hereinafter Press Release, Forescout Amended Agreement], https://www.globenewswire.com/news-release/2020/07/15/2062619/0/en/Forescout-and-Advent-International-Reach-Amended-Merger-Agreement.html [https://perma.cc/8UA3-HV3A].

5. Press Release, U.S. Dep't of Health & Human Servs., Secretary Azar Declares Public Health Emergency for United States for 2019 Novel Coronavirus (Jan. 31, 2020) [hereinafter Press Release, Public Health Emergency], https://www.hhs.gov/about/news/2020/01/31/secretary-azar-declares-public-health-emergency-us-2019-novel-coronavirus.html [https://perma.cc/WKN8-ZBRF].

6. The material adverse effect clause is also known as the material adverse change clause. The two are fundamentally equivalent, and in this Article I will refer to them collectively as MAE/MAC clauses or provisions.

7. Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 357 (2005).

MAE/MAC clauses as contractual devices that potentially facilitate efficient renegotiations in the face of adverse shocks is overstated.[8]

The sudden onset of COVID-19 in spring 2020 was, and remains, a tsunami-like event. It was totally unexpected and swept across the economy with frightening speed. It also threatens to extend well into the foreseeable future. COVID-19 is precisely the kind of adverse event that the MAE/MAC clause in merger agreements is intended to protect signatories against. The COVID-19 outbreak gives us a unique opportunity to evaluate the role the MAE/MAC clause plays in merger contracting. Most transactions pending at the outset of the COVID-19 outbreak in the U.S. closed notwithstanding the massive disruption brought on by the pandemic. In a small number of transactions, buyers refused to close, citing a MAE/MAC as the reason not to move forward with the merger. In three of those transactions, the parties sought to litigate the question of a MAE/MAC (i.e., Simon v. Taubman,[9] LVMH v. Tiffany,[10] and Forescout Technologies[11]), but ultimately settled their litigation by renegotiating the terms of their merger agreement. In Mirae's acquisition of Anbang's hotel assets, a court refused to declare a MAE/MAC, but permitted the buyer to walk away for breach of a seller's covenant.[12] In another transaction, the parties agreed to terminate the transaction voluntarily (i.e., Victoria's Secret[13]) rather than renegotiate or litigate the issue of whether there had been a MAE/MAC.

8. The former Chief Justice of the Delaware Supreme Court calls MAE/MAC clauses "renegotiation clauses." Allison Frankel, *COVID-19 MAE Cases Keep Ending with Revised Deals. That Wouldn't Happen Without Litigation*, REUTERS (Nov. 16, 2020), https://www.reuters.com/article/legal-us-otc-mae/covid-19-mae-cases-keep-ending-with-revised-deals-that-wouldnt-happen-without-litigation-idUSKBN27W2TH [https://perma.cc/2CL4-C4DM].

9. Complaint at 1–2, Simon Property Group, Inc. v. Taubman Centers, Inc., No. 2020-181675-CB (Mich. Cir. Ct. June 10, 2020).

10. LVMH's Verified Counterclaim and Answer to Verified Complaint at 2–3, Tiffany & Co. v. LVMH Moet Hennessy-Louis Vuitton SE, C.A. No. 2020-0768-JRS (Del. Ch. Sept. 28, 2020).

11. Press Release, Forescout Amended Agreement, *supra* note 4.

12. AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC, C.A. No. 2020-0310-JTL, 2020 Del. Ch. LEXIS 353 (Del. Ch. Nov. 30, 2020).

13. Verified Complaint at 1, Sycamore Partners III, L.P. v. L Brands, Inc., No. 2020-0306, 2020 WL 2061416 (Del. Ch. Apr. 24, 2020); James Fontella-Khan & Sujeet Indap, *Sycamore and L Brands Call Off Victoria's Secret Deal*, FIN. TIMES (May 4, 2020), https://www.ft.com/content/3f458e9c-e864-4fe1-8740-37136bae7b62 [https://perma.cc/94CS-HSP5].

The MAE/MAC provision is one of a number of risk-shifting clauses in the merger contract. In most cases, the MAE/MAC does this by assigning the risk of exogenous material adverse events between signing and closing to the buyer and the risk of endogenous material adverse events to the seller.[14] Because the MAE/MAC assigns the risk to the party best able to bear it, one can reasonably conclude that the MAE/MAC is an efficient term. Where there has been a MAE/MAC, the buyer is permitted to terminate the transaction and walk away, or the parties can renegotiate the terms of the agreement in order to facilitate an efficient transaction. Where there has been an adverse event that does not rise to a MAE, the buyer bears the risk of loss. However, because the MAE/MAC provision can act as a fulcrum for potential efficient renegotiations, the conventional wisdom is that the MAE/MAC provision has a subsidiary function as a renegotiation clause in the face of any adverse shock.

By now, it is clear, however, that courts are extremely reticent to permit a buyer to simply point to an adverse event between signing and closing and walk away from a transaction. Notwithstanding courts' reluctance, the conventional wisdom remains that following an adverse event, a buyer may lean on these clauses, and the threat of litigation, to push sellers to renegotiate the terms of merger agreements. This conventional wisdom overestimates the degree of judicial ambiguity surrounding modern MAE/MAC provisions. Where the parties overestimate judicial ambiguity, buyers may be able to take advantage of bargaining dynamics to hold up the seller and shift the cost of adverse shocks, at least in part, to sellers rather than bear them themselves. Renegotiating in the absence of a true MAE/MAC represents an inefficient ex post distribution of transaction surplus.

This Article seeks to illustrate the role MAE/MACs play in the merger agreement and understand how they may affect bargaining dynamics that accompany renegotiations of merger agreements. In particular, this Article adds to the literature on merger contracting by observing that the conventional wisdom with respect to the role played by MAE/MACs misapprehends the role of a modern MAE/MAC provision.

14. *See* Gilson & Schwartz, *supra* note 7, at 339, 345–46 (observing the risk-shifting traits of the MAE/MAC clause).

This Article proceeds in the following manner. Part I situates the discussion of the MAE/MAC as a lever for renegotiation by providing an overview of the conventional wisdom with respect to the role of MAE/MAC clauses following the occurrence of an adverse shock. Part II provides an overview of the MAE/MAC clause in merger agreements, including an analysis of the work MAE/MAC clauses are intended to accomplish in the contracting process. Part III provides an overview of the current state of the doctrine with respect to MAE/MAC clauses in Delaware. Part IV discusses the experience of merger parties with renegotiations in the wake of the COVID-19 outbreak. Specifically, this Part asks why there were so few renegotiations following the outbreak and how the conventional wisdom with respect to the role of MAE/MAC in renegotiations misapprehends its role. Finally, Part V summarizes and concludes.

I. CONVENTIONAL WISDOM: MAE/MACS AS RENEGOTIATION CLAUSES

The conventional wisdom holds that MAE/MAC clauses in merger agreements act as a fulcrum for efficient renegotiations in the face of adverse shocks between signing and closing. When faced with an adverse event that affects a seller's valuation, buyers may point to a MAE/MAC clause in an attempt to credibly threaten to terminate the transaction, thereby pushing sellers to agree to renegotiate the terms of the merger.

An example of such renegotiation during the COVID-19 pandemic involves private equity buyer Advent International's acquisition of Forescout Technologies. Forescout and Advent signed their merger agreement on February 6, 2020, with Advent paying $33 per share in cash for Forescout.[15] By the time they signed their agreement, public health experts, though perhaps not the general public, were already on the alert for the growing threat of the COVID-19 outbreak in China. On January 31, 2020, the Department of Health and Human Services ("HHS") had declared a National Public Health Emergency that empowered HHS to begin to

15. Press Release, Forescout, Forescout to Be Acquired by Advent International in $1.9 Billion Transaction (Feb. 6, 2020), https://www.forescout.com/company/news/press-releases/forescout-to-be-acquired-by-advent-international-in-1.9-billion-transaction/ [https://perma.cc/W2M6-7ULY].

respond to the threat of a pandemic in the U.S.[16] It was not until March 13, 2020, more than a month after Forescout and Advent signed their agreement, that the President declared a National Emergency with respect to COVID-19.[17]

By May, it was becoming apparent to Forescout that Advent was suffering buyer's remorse: a deal that looked good prior to the onset of a global pandemic looked less wonderful after the U.S. economy ground to a halt in an effort to battle the spread of COVID-19. Although Forescout had met all the conditions to closing the agreement, Advent dragged its feet and refused to close. On May 20, 2020, Forescout Technologies filed a lawsuit against Advent International seeking a declaratory judgment that the COVID-19 pandemic did not constitute a material adverse event under the merger agreement, as well as an order that Advent proceed and close the transaction.[18] The case was set for trial at the end of July 2020. Ultimately, Forescout and Advent settled the litigation through a renegotiation downwards of the merger price, and the transaction moved forward to closing.[19] Rather than go to trial, on July 15, 2020, Forescout and Advent agreed to an amended merger agreement. Under the renegotiated terms, Forescout shareholders would receive $29/share (87% of the original deal price), and Advent would move to close the transaction.[20]

At first blush, an observer might attribute the successful renegotiation of the terms of the merger agreement to the effect of COVID-19, but there is ultimately little or no reason to believe that the pandemic was the cause. The parties had specifically carved out of the definition of MAE/MAC any epidemic or pandemic. Although the onset of COVID-19 no doubt presented a challenge to Forescout and its business going forward, the contract clearly assigned the risk of this kind of adverse shock to Advent, the buyer. However, it subsequently came to light that in May 2020, during the executory period, the acquirer received a "whistle-blower" e-

16. Press Release, Public Health Emergency, *supra* note 5.

17. Donald J. Trump, *Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak*, WHITE HOUSE (Mar. 13, 2020), https://www.whitehouse.gov/presidential-actions/proclamation-declaring-national-emergency-concerning-novel-coronavirus-disease-covid-19-outbreak/ [https://perma.cc/3YTV-33PJ].

18. Press Release, Forescout Litigation, *supra* note 1.

19. Press Release, Forescout Amended Agreement, *supra* note 4.

20. *Id.*

mail from an employee of Forescout alleging accounting improprieties within the company. Unlike COVID-19, the risk of adverse internal shocks, like the disclosure of financial irregularities within the company, were risks assigned to the seller and not the buyer. Consequently, when Advent threatened to terminate the merger agreement unless the parties could renegotiate the terms due to disclosure of possible financial irregularities internal to Forescout, Advent's threat was credible.[21] This fuller story of Forescout and Advent is one that is recognizable to many in the deal world. It reflects the conventional wisdom with respect to MAE/MAC. However, it has little to do with the onset of COVID-19. Nevertheless, the idea that MAE/MAC clauses can act as levers for renegotiation of contracts following an adverse shock like COVID-19 has taken hold amongst practitioners.[22] Although slightly more hedged, a view that a MAE/MAC can act as a lever

21. Dean Seal, *Investors Sue Forescout over Nixed $1.9B Advent Takeover*, LAW360 (June 11, 2020, 8:33 PM EDT), https://www.law360.com/articles/1281979/investors-sue-forescout-over-nixed-1-9b-advent-takeover [https://perma.cc/NX5A-UH5A]; Luis Sanchez, *Why Forescout Is Taking a Much Lower Buyout Offer*, MOTLEY FOOL (Aug. 4, 2020), https://www.fool.com/investing/2020/08/04/why-forescout-is-taking-a-much-lower-buyout-offer.aspx [https://perma.cc/6AE3-4V3H].

22. Jessica DiNapoli, *In Row with Tiffany, LVMH May Find That Most Sales Are Final*, REUTERS (Sept. 18, 2020, 7:32 AM), https://www.reuters.com/article/tiffany-m-a-lvmh-delaware-analysis-idUSKBN2691Q8 [https://perma.cc/42KW-D4BR] (describing renegotiation as an alternative to litigation); STEVEN M. BRAGG, MERGERS & ACQUISITIONS: A CONDENSED PRACTITIONER'S GUIDE 173 (2009) (noting that a MAE may serve to facilitate renegotiation of contract terms); Steven Davidoff Solomon, *In Abbott's Bid to Halt Purchase of Alere, the MAC Makes a Comeback*, N.Y. TIMES (Dec. 7, 2016), https://www.nytimes.com/2016/12/07/business/dealbook/abbott-laboratories-alere-mac-clause.html [https://perma.cc/8N7N-D53W] ("MAC assertions were really part of the negotiation dynamic among the parties as the financial crisis took hold. A buyer can invoke a MAC clause to try to drive down the price of an acquisition by taking advantage of either changed market conditions or adverse events affecting the target company."); Nick Brown, *Cerberus Seeks Lower Price on Innkeepers*, REUTERS (Aug. 24, 2011), https://www.reuters.com/article/us-innkeepers/cerberus-seeks-lower-price-on-innkeepers-sources-idUSTRE77N5MC20110824 [https://perma.cc/QA2R-8868] ("Most likely, Miller said, both sides will reopen talks and settle on a new takeover price, especially given that Cerberus and Chatham have already done due diligence."); Abigail Hathaway, *Buyer's Remorse and "MAC Outs" in M&A Agreements*, CLS BLUE SKY BLOG (Mar. 18, 2016), https://clsbluesky.law.columbia.edu/2016/03/18/buyers-remorse-and-mac-outs-in-ma-agreements/ [https://perma.cc/P64Z-S9Y9]; *Revisiting the MAC Clause in Transaction Agreements: What Can Counsel Learn from the Credit Crisis?*, A.B.A. (Aug. 20, 2010), https://www.americanbar.org/groups/business_law/publications/blt/2010/08/03_herman/ [https://perma.cc/64M3-W2RB]; 1 ABA MODEL STOCK PURCHASE AGREEMENT WITH COMMENTARY 268 (Murray Perelman ed., 2d ed. 2010) (explaining that a buyer may prefer a price renegotiation rather than engaging in costly litigation over a MAE); Eric L. Talley, *On Uncertainty, Ambiguity, and Contractual Conditions*, 34 DEL. J. CORP. L. 755, 788 (2009) ("A number of practitioners . . . suggested that, in addition to concerns about uncertainty, one of the key reasons for a MAC/MAE provision is to provide a backdrop for possible deal restructuring should market conditions change.").

to facilitate efficient renegotiation is by now widely accepted by academics (the present author is not excluded from that number).[23]

The conventional wisdom posits the MAE/MAC clause as a fulcrum for renegotiations following adverse shocks, like COVID-19, between signing and closing. An adverse shock between signing and closing can reasonably be expected to reduce the valuation of the seller in the eyes of the buyer. Whether any such decline is sufficient to rise to the level that a court would declare the adverse event a MAE/MAC is thought to be ambiguous. According to conventional wisdom, due to this judicial ambiguity buyers can credibly threaten to invoke the MAE/MAC clause to terminate the merger agreement and force a renegotiation that transfers transaction surplus from the seller to the buyer, thus causing the seller to share in at least a portion of the losses sustained by adverse shocks prior to signing. The conventional wisdom, while not entirely incorrect, does, as we shall see, tend to overstate the case with respect to the utility of the MAE/MAC as a renegotiation clause.

23. CLAIRE HILL, BRIAN JM QUINN & STEVEN DAVIDOFF SOLOMON, MERGERS & ACQUISITIONS: LAW, THEORY, AND PRACTICE 364 (2d ed. 2019) (noting the role MAE clauses play in facilitating renegotiations); David J. Denis & Antonio J. Macias, *Material Adverse Change Clauses and Acquisition Dynamics*, 48 J. FIN. & QUANT. ANALYSIS 819, 819 (2013) (finding that MACs are responsible for 80% of renegotiations of merger agreements in their sample); Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2089 (2009) ("Because some level of disruption in the party's business is highly foreseeable, and because the actual disruption is not likely to MAC the business, a counterparty declaring a MAC on the basis of materializing agreement risks is likely to be behaving opportunistically [by renegotiating the merger contract]."); Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 888–92 (2010) (arguing that vague MAE clauses are efficient partly because vague judicial standards facilitate renegotiation); Eric Talley, Drew O'Kane, Christian Kellner & Alexander Stremitzer, *The Measure of a MAC: A Machine-Learning Protocol for Analyzing Force Majeure Clauses in M&A Agreements*, 168 J. INSTITUTIONAL & THEORETICAL ECON. 181, 183 (2012); Steven M. Davidoff & Kristen Baiardi, Accredited Home Lenders v. Lone Star Funds*: A MAC Case Study* 19 (Wayne State Univ. Law Sch. Legal Studies Research Paper Series, Paper No. 08-16, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1092115 [https://perma.cc/PHM9-LQSJ] (reasoning that if a buyer credibly asserts a MAE, then both parties have incentives to renegotiate to a lower price to avoid an all-or-nothing litigation outcome).

II. THE ROLE OF THE MAE/MAC IN MERGER AGREEMENTS

In contracts, "a deal's a deal" is the rule.[24] In contracts, parties may at times seek to excuse performance of their obligations, relying on the doctrines of impracticability and frustration.[25] To the extent there are foreseeable risks, parties making unqualified promises to perform necessarily assume an obligation to perform even if the occurrence of a foreseeable adverse event makes performance impracticable. Absent contractual strategies to limit one's obligation to perform, courts will traditionally enforce parties' agreements. These basic contractual doctrines are no less true in the context of mergers and acquisitions, where parties are typically represented by sophisticated counsel and negotiations are usually meticulously fought.

The terms of merger agreements are highly negotiated. Rather than rely on doctrines of excuse, like impracticability and frustration, parties to merger agreements have the ability to look forward and envision a limited set of scenarios that might give rise to contractual rights to terminate the merger agreement pursuant to its terms and thus avoid the expense and risk involved in litigating excused performance. For example, merger agreements typically include numerous conditions; failure of any condition at closing will relieve the buyer from the obligation to complete the transaction. One such condition is a successful shareholder vote. In the event shareholders do not vote to approve the transaction, the condition requiring a vote fails and the buyer is permitted to walk away from the transaction without incurring a penalty. Other common conditions include government approval, required approvals by other private third parties (e.g., landlords), and financing entities, to name a few.

The traditional role of a material adverse change clause in a merger agreement has been functionally equivalent to that of a force majeure clause, which acts to excuse performance in the

24. Waukesha Foundry v. Indus. Eng'g, 91 F.3d 1002, 1010 (7th Cir. 1996) ("*Pacta sunt servanda*, or, 'a deal's a deal.'").

25. The doctrine of impracticability excuses performance of a duty, where the said duty has become unfeasibly difficult or expensive for the party who was to perform. *See* E. ALAN FARNSWORTH, CONTRACTS 624, 626 (4th ed. 2004). Frustration of purpose occurs when an unforeseen event undermines a party's principal purpose for entering into a contract such that the performance of the contract is radically different from performance of the contract that was originally contemplated by both parties. *Id.* at 634.

event an adverse shock between signing and closing makes performance by the buyer impracticable or frustrates the buyer's purpose.[26] In that sense, the traditional MAE/MAC negotiated as part of the merger agreement acts to excuse the buyer from performance.[27] The role of the MAE/MAC clause has changed over time, shifting it away from that of force majeure clauses to excuse buyer performance in the event of adverse shocks to one that ensures buyer performance in spite of adverse shocks.

In the context of a merger agreement, the material adverse effect clause operates as a condition to closing, as a representation, and/or to qualify a representation.[28] The typical closing condition states that a buyer need not close the transaction in the event there has been a material adverse effect.[29] In the alternative, the MAE/MAC representation (the "back-door MAC") forms the basis for a termination right when read together with the "bringdown condition." The bringdown condition refreshes the seller's representations as of the closing date. To the extent there has been a material adverse change, the seller's representation will not correct when the representations are brought down to the closing, thus triggering a failure of the condition.[30] In either event, a material adverse change between signing and closing permits the buyer to decline to close the transaction for failure of a condition and then terminate the transaction pursuant to its terms, walking away

26. *See, e.g.*, Mellon Bank, N.A. v. Aetna Bus. Credit, 619 F.2d 1001, 1015–16 (3d Cir. 1980).

27. I use the term "traditional MAE/MAC" in the manner used by Gilson and Schwartz to describe a MAE/MAC without any carveouts. *See* Gilson & Schwartz, *supra* note 7; *see also infra* Part III (discussion of MAE/MAC structure).

28. A representation that there has not been a MAE/MAC is known as a "back-door MAC." *See, e.g.*, James R. Griffin, *2009 M&A Deal Point Study: Strategic Buyer/Public Targets*, M&A LAW., Nov./Dec. 2009, at 4.

29. *See, e.g.*, Agreement and Plan of Merger Between Ferrari Group Holdings, L.P., Ferrari Merger Sub, Inc., and Forescout Technologies, Inc. (Form 8-K, Exhibit 2.1), § 7.2(d) (Feb. 6, 2020), https://www.sec.gov/Archives/edgar/data/1145057/000110465920012189/tm206949d3_ex2-1.htm [https://perma.cc/3GPY-BYLW] ("No Company Material Adverse Effect will have occurred after the date of this Agreement that is continuing."). In addition to the bringdown condition, parties to complex contracts will also negotiate stand-alone termination provisions that permit one or both parties to terminate the pending contract pursuant to its terms. The fiduciary termination right is a common termination provision, as is the termination right triggered by what is known as the "drop dead date."

30. *Id.* § 7.2(a)(ii) ("The representations and warranties . . . that are qualified by [a] Company Material Adverse Effect . . . [are] true and correct in all respects . . . as of the Closing Date as if made at and as of the Closing Date.").

without paying a termination fee or damages.[31] In addition to the bringdown condition, parties often negotiate a MAE as a separate termination right. The MAE/MAC termination right functions slightly differently from the bringdown condition. The bringdown condition permits the buyer to decline to close once the seller makes a determination that the seller has otherwise comported with the conditions to closing. The MAE/MAC termination right, on the other hand, permits the buyer to declare a MAE/MAC and proactively terminate the merger agreement without necessarily giving the seller the opportunity to cure the MAE/MAC or waiting for the seller to close the transaction.

A. *Structure of a Typical MAE Clause*

The material adverse effect clause is made up of three basic components. In the first instance, the MAE/MAC places residual post-signing risks with the seller. The MAE/MAC is typically defined as a circumstance that has or would reasonably be expected to have a material adverse effect on the business or the financial condition or results of operations of the target company.[32] Of course, this definition of a MAE/MAC is almost impossibly vague. In general, however, the use of this traditional formulation of the MAE/MAC makes it clear that if, during the interim between signing and closing, a material adverse shock occurs, then the seller bears the cost of that adverse shock and not the buyer, who will not be required to close.

Second, parties negotiate to trim back the buyer's ability to walk away from the deal by carving out from the definition of a material adverse event certain foreseeable exogenous adverse events that lie out of the control of both parties, like adverse changes in the general economic conditions, financial markets, or regulatory, legislative or political conditions, among others.[33] The effect of each of these carveouts is to limit the application of the broad MAE/MAC definition by excluding certain categories of foreseeable exogenous

31. Andrew A. Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 820 (2010) ("[T]he MAC clause allows the acquirer to costlessly avoid closing the deal if the target's business suffers a sufficiently adverse change during the executory period.").

32. Kenneth A. Adams, *A Legal-Usage Analysis of Material Adverse Change Provisions*, 10 FORDHAM J. CORP. & FIN. L. 9, 9, 17 (2004).

33. *Id.* at 43–44.

adverse events. Although they might look like boilerplate, the events carved out of the MAE/MAC definition are often highly negotiated. For example, it is common for parties to agree to carve out from the MAE/MAC definition certain force majeure events, like earthquakes, floods, wildfires or other natural disasters, weather conditions, pandemics, and other force majeure events.[34] Professor Miller breaks down the various carveouts into three separate categories: systematic risks (associated with general changes in the economy, financial markets, and the industry of the target); indicator risks (associated with the target's financial performance, including failure to meet financial projections and the estimates of industry analysts); and finally agreement risks (associated with adverse effects directly tied to execution of the merger agreement).[35] To the extent a material adverse event occurs between signing and closing and it falls under one of these exceptions, it cannot form the basis for the buyer to terminate the merger agreement. The implication of the carveouts is to place the risk of certain foreseeable exogenous events back on to the buyer, leaving the target holding only adverse risks endogenous to the target.

The third component of the MAE definition is the disproportionate-effect language that modifies all or some of the carveouts. Parties will often negotiate a carveout for a particular adverse exogenous event (e.g., an adverse change in financial markets), so if in the event of a market collapse between signing and closing, that collapse would not be considered a material adverse effect, unless the target company suffered a disproportionately large loss relative to other firms in the same industry as a result of the collapse.[36] The intent of the disproportionate-effect language is to claw back at least some of the risk protection given the seller through the broad carveouts for downturns in the economic climate, financial markets, natural disasters, as well as pandemics like COVID-19. To the extent a financial downturn or natural disaster adversely affects the entire sector in which the target operates, it may nevertheless be a MAE if the target, for reasons endogenous to the

34. *Force Majeure Clauses—Checklists and Sample Wording*, WORLD BANK GROUP PUB.-PRIV.-PARTNERSHIP LEGAL RESOURCE CTR., https://ppp.worldbank.org/public-private-partnership/ppp-overview/practical-tools/checklists-and-risk-matrices/force-majeure-checklist [https://perma.cc/58A5-2JNS].

35. Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2073–89 (2009).

36. Adams, *supra* note 32, at 43–44; *see also infra* Appendix, Representative MAE.

target, is more significantly affected than its industry competitors. In this way, the carveouts play an important screening function. Adverse shocks that have idiosyncratic effects on the target, though the shocks are ostensibly exogenous, may reveal hidden information about the target. In that way, the disproportionate-effects language helps screen for semi-endogenous risks (exogenous risks that have idiosyncratic effects on the target) and assigns those risks to the seller rather than the buyer.

The structure of the modern MAE/MAC provision differs significantly from the traditional MAE/MAC. The addition of numerous carveouts for systemic, indicator and agreement risks allocates the risk of these adverse exogenous events between signing and closing to the buyer, thus turning the traditional MAE/MAC on its head. While the buyer holds the risk of exogenous events, the target bears endogenous and semi-endogenous risks, which are all ostensibly within the control of the target.

B. *Rationales for the MAE/MAC Provision*

The so-called traditional MAE/MAC includes only the first component of this three-part formulation.[37] In that form, the traditional MAE/MAC is a highly buyer-favorable provision that acts effectively like a typical force majeure clause. Although more common in international commercial contracts, a typical force majeure clause excuses performance in the event of an exogenous event that could not be reasonably foreseen at the time of contracting, the effects of which cannot be reasonably mitigated by the party seeking to avoid performance.[38] Under the common law, contracting parties can be excused from performance under the doctrine of impracticability or the related doctrine of frustration.[39]

37. Gilson & Schwartz term the MAE without any carve outs a "traditional" MAE. *See* Gilson & Schwartz, *supra* note 7, at 331–37.

38. INT'L CHAMBER OF COMMERCE, FORCE MAJEURE AND HARDSHIP CLAUSES (Mar. 2020), https://iccwbo.org/content/uploads/sites/3/2020/03/icc-forcemajeure-hardship-clauses-march2020.pdf [https://perma.cc/SH2P-4K6W]; UNIDROIT PRINCIPLES art. 7.1.7 (Force Majeure), https://www.unidroit.org/instruments/commercial-contracts/unidroit-principles-2010/404-chapter-7-non-performance-section-1-non-performance-in-general/1050-article-7-1-7-force-majeure [https://perma.cc/AB7U-B7UD].

39. Schwartz, *supra* note 31, at 789 (arguing that MAE/MAC clauses implicate the traditional contract doctrine of frustration).

Like its cousin force majeure, impracticability requires the occurrence of an event that attacks the basic assumption of the contract. As with force majeure, there must be an occurrence of a condition, the nonoccurrence of which was a basic assumption of the contract, that makes performance extremely expensive or difficult to complete; further, the impracticability must have resulted without the fault of the party seeking to be excused.[40] For a court to determine that a party may excuse performance under the doctrine of frustration, that party must first show that the adverse event "substantially frustrated" the party's "principal purpose"; second, the party must show that the purpose was a "basic assumption" of the contract; third, frustration must have resulted without fault of the party seeking to be excused; and finally, the party seeking to be excused must not assume a greater obligation than the law imposes.[41] Professor Schwartz observes that although frustration and impracticability are extremely high bars for contract performance, parties can, and do, negotiate frustration clauses that lower the bar for relief by relying on materiality qualifiers.[42]

Like a force majeure clause, a negotiated frustration clause may also include a list of specific adverse events, the occurrence of which will presumptively result in an excusal from performance. Unlike a force majeure clause, such events more typically involve the economic atmosphere that gives incentive to the transaction, like "severe reduction in demand" or "radically changed market conditions."[43] Central to the understanding of the traditional MAE/MAC as a force majeure/frustration clause is that the occurrence of an *exogenous* material adverse event gives rise to a right by the buyer to terminate the transaction and walk away. To the extent the adverse event lies within the control of the buyer, the buyer may not rely on the clause to terminate the transaction.[44]

In their influential paper on MAE/MAC clauses, Professors Gilson and Schwartz explain the role of the MAE/MAC in merger

40. 2 E. ALLEN FARNSWORTH, FARNSWORTH ON CONTRACTS § 9.6 (2d ed. 1998); RESTATEMENT (SECOND) OF CONTRACTS § 261 (AM. LAW INST. 1981).

41. 2 FARNSWORTH, *supra* note 40, § 9.7; RESTATEMENT (SECOND) OF CONTRACTS § 265 (AM. LAW INST. 1981).

42. Schwartz, *supra* note 31, at 806–07.

43. *Id.* at 810.

44. *See id.* at 812 ("A 'reduction in demand,' for instance, might be due to changing tastes of fickle consumers (an exogenous cause) or a poorly executed advertising campaign (an endogenous cause).").

agreements, as well as the expansion in the use of exceptions to the MAE/MAC clause in recent years.[45] Gilson and Schwartz advance two possible explanations for the extensive use of MAE/MACs in merger agreements. First is the symmetry hypothesis. Under the symmetry hypothesis, the traditional MAE/MAC exists to provide symmetry for buyers against an effective judicial out that sellers have.[46] Development of the takeover jurisprudence starting in the mid-1980s gave rise to the judicial obligations of sellers to include fiduciary termination rights in merger agreements.[47] The traditional MAE/MAC steps into the breach and provides buyers a roughly symmetrical equivalent to the seller's fiduciary termination right—if between signing and closing circumstances dramatically change to reduce the value of the target, the buyer is permitted to terminate the transaction.[48] In that sense, the MAE/MAC plays the role of the force majeure/frustration clause as predicted by Professors Gilson and Schwartz. However, Gilson and Schwartz find a lack of empirical support for this position.[49]

The second hypothesis Professors Gilson and Schwartz put forward is the investment hypothesis.[50] Because the traditional MAE/MAC imposes exogenous risks on the target, the investment hypothesis holds that buyers and sellers agree to include carveouts to the MAE/MAC definition to reduce the degree of ambiguity associated with the MAE/MAC provision. This creates incentives for the target to continue to make corporate investments necessary between signing and closing (i.e., to overcome moral hazard inherent in the last-period problem).[51] A secondary result of the investment hypothesis is to flip the assignment of exogenous risks from the seller to the buyer and to, in effect, curtail the ability of the MAE/MAC to act as a force majeure/frustration clause. On the other hand, assigning exogenous risks to the buyer is more efficient

45. *See* Gilson & Schwartz, *supra* note 7, at 330.
46. *Id.* at 336.
47. *Id.* at 335.
48. *Id.*
49. *Id.* at 345.
50. *Id.* at 349.
51. *Id.* at 345; *see* Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1947–1953 (2003) (discussing the last-period problem in merger transactions).

because the costs of an exogenous risk, which will only really materialize after the closing of the transaction, are borne by the buyer and not the seller.[52]

At the time of Gilson and Schwartz's article in 2005, contracting practices typically limited the use of carveouts to deals involving technology sector targets. Gilson and Schwartz observed an increasing tendency in the high technology sector to expand the list of carveouts, the effect of which is to shift the risk of undiversifiable, exogenous adverse events from the target to the buyer in technology transactions.[53] Gilson and Schwartz argued that such an observation was consistent with their investment hypothesis. They predicted that carveouts would become common in transactions requiring important post-signing seller investments to maintain the value of the target going forward, like technology businesses and businesses dependent on critical human resources.[54]

Although the symmetry theory is attractive, Gilson and Schwartz found that it lacks empirical support.[55] The symmetry theory suggests reliance on a traditional MAE/MAC where the costs of exogenous risks are borne by the seller. However, the increasing reliance on carveouts in business sectors susceptible to post-signing moral hazard suggests that the option value of symmetrical walk rights is low relative to other potential explanations for the use of MAE/MAC provisions. Gilson and Schwartz conclude that by shifting the cost of exogenous risks to the buyer through the use of carveouts and leaving the costs of endogenous risks with the seller, the merger contract better mitigates post-signing moral hazard and more efficiently allocates risks to the parties best positioned to absorb them.[56]

While Gilson and Schwartz theorize the motivations for MAE/MAC clauses and the carveouts, Professors Choi and Triantis add to Gilson and Schwartz's analysis by introducing the effect of vagueness of the MAE/MAC contract term on bargaining dynamics.[57] Although commentators have urged on practitioners the

52. Gilson & Schwartz, *supra* note 7, at 346–47.
53. *Id.* at 332–33.
54. *See id.* at 340.
55. *Id.* at 349.
56. *See id.* at 345.
57. *See* Choi & Triantis, *supra* note 23, at 854.

adoption of numerical triggers to MAE/MAC conditions, dealmakers have steadfastly resisted such entreaties. They instead rely on more vague descriptions of material adverse events for purposes of the MAE/MAC clause, leaving definition of a MAE/MAC to the courts.[58]

Choi and Triantis observe that rather than mistakes, decisions by drafters to avoid specificity with respect to the MAE/MAC definition are strategic choices.[59] They argue that vagueness in the MAE/MAC definition generates incentives that help the parties overcome the problems of asymmetric information in the contracting.[60] The role of carveouts in the MAE/MAC definition, they argue, is to reduce noise and sharpen the effectiveness of the MAE/MAC as a signal for private information.[61] In addition, vagueness associated with the MAE/MAC provision facilitates efficient renegotiation of merger agreements following adverse shocks that have the effect of reducing the buyer's valuation of the target.[62] Vagueness results in enforcement costs associated with litigating the merger agreement. Because sellers must bear the costs of enforcement, the litigation costs associated with enforcing a MAE/MAC provision can act as a screen to extract additional private information from the seller and promote efficient renegotiations.[63] Only where the seller believes there to be a credible threat with respect to judicial enforcement of the merger contract will it pursue litigation and enforcement. Where the seller's litigation threat is not credible, because the seller has reason to know, given its private information, that adverse shock exceeds the judicial threshold for a MAE/MAC, sellers will have an incentive to pursue renegotiation.[64] Such renegotiations may be efficient because only "good" sellers who have private information and know their likelihood of success on their MAE/MAC claim is high will pursue costly litigation, while sellers who have private information that suggests their MAE/MAC claim will fail will not have an incentive to pursue such litigation.[65] With private seller information about the nature of the adverse shock

58. *See id.* at 880–81.
59. *Id.* at 855.
60. *Id.* at 859.
61. *Id.* at 867.
62. *See id.* at 891–92.
63. *Id.*
64. *Id.* at 891.
65. *See id.* at 894–95.

with respect to the seller so revealed, buyers and sellers can successfully renegotiate, efficiently shift costs associated with the adverse shock to the seller, and move to closing.[66]

The challenge with a critique that MAE/MAC provisions are too vague is that it suggests there is a normal distribution of judicial outcomes around the mean definition of a MAE. It further assumes courts will almost randomly determine that some events rise to the level of a MAE/MAC and others do not, and that buyers and sellers cannot reliably predict how a court might rule when asked to determine the meaning of the provisions. This seemingly random distribution of judicial outcomes gives rise to ambiguity with respect to determining whether any specific adverse shock will potentially receive a judicial determination of a MAE/MAC. However, with respect to MAE/MAC provisions, courts in Delaware have only ever *once* permitted a buyer to walk away from a merger agreement due to a MAE/MAC.[67] This suggests that rather than being strategically vague, there is a high degree of predictability with respect to how courts will find on legal challenges seeking to enforce claimed MAE/MACs. As a consequence, when sellers agree to negotiate in response to a buyer's refusal to close, they are not necessarily revealing private information about the nature of the adverse shock, but are rather exhibiting risk aversion (i.e., overestimating their own litigation risk).

III. WHAT DO COURTS SAY ABOUT MAE/MAC CLAUSES?

Typically, in contract, when parties reach an agreement on a bargain, courts will enforce the agreement. The fact that circumstances may have changed between signing and closing does not generate a per se right for parties to walk away from their obligations under the terms of the agreement. Courts have developed a number of doctrines of excuse (e.g., the doctrines of frustration, impracticability, and force majeure) that will excuse contractual performance.[68] Rather than rely on these doctrines of excuse, in the

66. *Id.* at 896.

67. Akorn, Inc. v. Fresenius Kabi AG, C.A. No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325 (Del. Ch. Oct. 1, 2018) (finding a MAE and permitting buyer to terminate a merger agreement).

68. *See, e.g.*, Aluminum Co. of Am. v. Essex Grp., Inc., 499 F. Supp. 53, 70–71 (W.D. Pa. 1980) ("The doctrine of mistake of fact requires that the mistake relate to a basic assumption on which the contract was made. The doctrine of impracticability requires that the non-

context of merger agreements, parties lean on MAE/MAC provisions to contract around the obligations to close in situations where impracticability or frustration might otherwise arise. That said, courts are hesitant to reach the conclusion that a MAE/MAC has occurred that will allow buyers to walk away from a merger agreement.[69] Prior to the 2010s, that hesitance might well have be attributed to the inherent vagueness of the material adverse effect clause itself. However, recent cases make it clear that courts and dealmakers have internalized the prevailing academic view of the MAE/MAC, and that the court's hesitance to enforce is due not to vagueness of the contracted term, but to the changed nature of the provision's purpose.

The earlier view of the MAE/MAC as a broad force majeure/frustration clause has, over time, given way in the context of merger contracting to a contrary provision that, in effect, reads out common law performance excuses and turns the MAE/MAC into a risk-shifting provision that places the burden of adverse exogenous events—including force majeure events—on the buyer and not the seller. Of the MAE/MAC cases, there are three that are important for understanding the development of the Delaware courts' doctrine in this area: *In re IBP, Inc. Shareholders Litigation*,[70] *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*,[71] and *Akorn v. Fresenius*.[72] In *IBP*, the court was asked to apply a traditional MAE/MAC. Later, in *Hexion* and *Akorn*, following developments in contracting practice, the thinking of courts evolved to reflect the current merger contracting practices with respect to modern MAE/MAC provisions.

occurrence of the 'event', . . . or the non-existence of the 'fact', . . . causing the impracticability be a basic assumption on which the contract is made." (citations omitted)).

69. Timothy Harkness, Kate Apostolova & Nathan Hembree, *Do I Have to Go Through With This? A Summary of Recently Filed MAE/MAC Cases*, FRESHFIELDS BRUCKHAUS DERINGER L. BLOG (Apr. 19, 2020), https://blog.freshfields.us/post/102g53q/do-i-have-to-go-through-with-this-a-summary-of-recently-filed-mae-mac-cases [https://perma.cc/25FG-9J5S] ("[T]ransaction terminations based on the occurrence of an MAE/MAC are rare, and the standard by which Delaware courts judge whether an MAE/MAC has occurred is incredibly high.").

70. 789 A.2d 14, 52 (Del. Ch. 2001). Although *IBP* involved a Delaware court interpreting New York law, its reasoning was later adopted in toto by the Delaware Chancery Court in *Frontier Oil*. Frontier Oil Corp. v. Holly Corp., C.A. No. 20502, 2005 Del. Ch. LEXIS 57, at *127–28 (Del. Ch. Apr. 29, 2005).

71. 965 A.2d 715, 738 (2008).

72. *Akorn*, 2018 Del. Ch. LEXIS 325.

A. *IBP Shareholders Litigation*

In re IBP, Inc. Shareholders Litigation is perhaps the best known, and most important, of the MAE/MAC cases.[73] Although *IBP* was decided by a Delaware court interpreting New York law, it is nevertheless the seminal case for thinking about the MAE/MAC.[74] In *IBP*, Tyson Foods, the nation's leading chicken distributor, sought to walk away from an agreement to acquire IBP, the number-one beef and number-two pork distributor in the country, following a vigorous auction.[75] Tyson's decision to attempt to terminate the merger agreement was preceded by a severe winter, which adversely affected the performance of both Tyson and IBP equally, as well as the disclosure of financial irregularities at an IBP subsidiary.[76] Tyson pointed to both of these and sought to exercise its right to avoid performance due to there being a material adverse effect.[77]

The MAE clause in *IBP* was a traditional MAC in that it contained only the first of the three components of the now-typical MAE formulation.[78] There was no language carving out exceptions to the definition or disproportionate effect on the seller.[79] The central question for the court in *IBP* involved an interpretation of the definition of the traditional MAE/MAC that gave rise to Tyson's purported right to avoid performance. The traditional MAE/MAC relied on by the parties in *IBP* was drafted with purposefully broad and vague language.[80] *IBP*'s traditional MAE/MAC played the role of a force majeure/frustration clause. Such clauses are broadly drafted but typically provide for a termination right in the event of a specified adverse event (e.g., war, rebellion, earthquakes,

73. 789 A.2d at 52.

74. Although *IBP* is not precedent, the reasoning in *IBP* was later adopted in *Frontier Oil*. *See Frontier Oil Corp.*, 2005 Del. Ch. LEXIS 57, at *128.

75. *In re IBP, Inc.*, 789 A.2d at 21.

76. *Id.* at 22, 27–28.

77. *Id.* at 51–52.

78. *See supra* section II.A.

79. *In re IBP, Inc.*, 789 A.2d at 65–66.

80. *Id.* at 65 ("Under the contract, a material adverse effect (or 'MAE') is defined as 'any event, occurrence or development of a state of circumstances or facts which has had or reasonably could be expected to have a Material Adverse Effect' . . . 'on the condition (financial or otherwise), business, assets, liabilities or results of operations of [IBP] and [its] Subsidiaries taken as whole. . . .'").

drought, flood, etc.) during the pre-closing period.[81] *IBP*'s MAE/MAC definition mirrored such a clause but without the enumerated list of adverse events.

In evaluating the buyer's claims, the court read the role of the traditional MAE/MAC as that of a force majeure/frustration clause and laid out a three-pronged approach to interpreting these provisions:

> [E]ven where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from [1] the occurrence of unknown events that [2] substantially threaten the overall earnings potential of the target in [3] a durationally-significant manner. A short-term hiccup in earnings would not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror.[82]

It is left to the finder of fact to determine whether the adverse event in question rises to the level of a MAE/MAC so as to trigger the buyer's right to walk. The key for the court's understanding whether an adverse event is material for purposes of the MAE/MAC must be "viewed from the longer-term perspective of the reasonable acquirer."[83] The buyer, after all, buys the company for the long term and is not necessarily dissuaded by short term blips in performance or ambient economic conditions that it will have to endure in any event beginning immediately following closing of the transaction.[84]

Of course, Delaware courts typically eschew bright-line rules and view this kind of ambiguity as a net positive for the application of the corporate law.[85] In *IBP*, Vice Chancellor Strine noted that a "broadly written" MAE provision "is best read as a backstop protecting the acquiror from the occurrence of *unknown events*. . . ."[86] Broadly drafted provisions grant a high degree of discretion to the

81. *See, e.g.*, *Force Majeure Clauses—Checklists and Sample Wording*, *supra* note 34; *Practical Guidance*, *Commercial Clause Description—Miscellaneous: Force Majeure*, BLOOMBERG L. (2019), https://www.bloomberglaw.com/product/corporate/document/XD6TO5TS000000 [https://perma.cc/AY5Y-6TWS].

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

83. *Id.*

84. *Id.* at 67 ("It is odd to think that a strategic buyer would view a short-term blip in earnings as material, so long as the target's earnings-generating potential is not materially affected by that blip or the blip's cause.").

85. William T. Allen, *Ambiguity in Corporation Law*, 22 DEL. J. CORP. L. 894 (1997).

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

finder of fact and may improve efficiency in contract drafting as parties will inevitably find the ex ante cost of specifying all material risks to the contract prohibitively expensive.[87] In that sense, the MAE/MAC provision acts as a force majeure clause. In a footnote, Vice Chancellor Strine remarked that the court's approach to interpreting traditional MAE/MAE clauses "as addressing fundamental events that would materially affect the value of a target to a reasonable acquiror eliminates the need for drafting [extremely detailed MAC clauses with numerous carveouts or qualifiers]" akin to the way drafters typically draft force majeure provisions, which will include specific lists of "act of God" events that will presumptively result in a termination right by the buyer.[88]

Because this definition of a MAE/MAC is forward-looking, it is, as Choi and Triantis observe, necessarily vague. As the well-known American philosopher Yogi Berra once said, "'It's tough to make predictions, especially about the future.'"[89] Adverse events that occur during the eight-to-twelve-week pre-closing period rarely announce themselves as durationally significant.[90] Indeed, it is normally impossible for an informed observer to accurately predict whether an adverse event will be sufficiently long-lasting as to affect the long-term earnings potential of the target and thus trigger the MAE/MAC condition.[91] Consequently, the traditional MAE/MAC formulation is sufficiently vague as to be an invitation to litigation in the manner predicted by Choi and Triantis.

B. Huntsman v. Hexion

The global financial crisis of 2008, like the COVID-19 outbreak, represented a rapid and dramatic shift in economic performance

87. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 43–68 (1996).

88. *In re IBP, Inc.*, 789 A.2d at 68 n.155.

89. *The Perils of Prediction*, ECONOMIST (May 31, 2007), https://www.economist.com/books-and-arts/2007/05/31/the-perils-of-prediction [https://perma.cc/Z6WY-8ME7] (attributing the quote to Yogi Berra).

90. *Cf. In re IBP, Inc.*, 789 A.2d at 67 (discussing how a short-term hiccup would not amount to an adverse event, and a durationally significant adverse event usually spans years, not mere months).

91. *Cf.* Robert Malionek & Jon Weichselbaum, *Five Keys to Analyzing a Material Adverse Effect*, N.Y. L.J. (Mar. 6, 2019), https://www.lw.com/thoughtLeadership/five-keys-analyzing-material-adverse-effect-ny-law-journal [https://perma.cc/XG5K-N7SL] (explaining how it is difficult to determine whether an event is materially adverse, and in particular, the difficulty in determining whether an event is durationally significant).

across the entire economy. As lending markets froze, the prospects for private-equity-sponsored deals dimmed. Illiquid credit markets were especially difficult for pending transactions. Buyers entered into transactions thinking that they would be able to rely on the financial markets to provide the necessary financing but then were left unable to complete transactions when these markets froze.[92] *Hexion* was one such case where the sudden illiquidity of lending markets caused the buyer to engage in second thoughts about the wisdom of the proposed acquisition.[93]

Following a competitive bidding process for Huntsman Corp. in July 2007, Hexion agreed to "pay a substantially higher price than the competition and to commit to stringent deal terms, including no 'financing out.'"[94] Consequently, the buyer took on the risk of being able to secure financing to make the deal happen. However, following difficulties in the financial markets in June 2008, Hexion sought to walk away from the transaction by filing suit, making two arguments.[95] First, that financing in the amount necessary to complete the transaction was no longer available in the market; and second, even if Hexion were able to secure financing to complete the transaction as proposed, the combined entity would be immediately insolvent.[96] The buyer sought a declaratory order from the court that Huntsman had suffered an MAE/MAC under the terms of the merger agreement and that the buyer would no longer be required to close the transaction.[97]

By the time of the *Hexion* litigation, market practice and the understanding of the courts with respect to the role of the MAE had already changed. *IBP* market practice limited the use of MAE/MAC carveouts to deals in the technology sector. However, by the time of *Hexion*, some eight years later, carveouts to the MAE/MAC definition had become much more common.[98] Unlike

92. *See, e.g.*, Hexion Specialty Chems., Inc. v. Hunstman Corp., 965 A.2d 715, 720–21, 731 (Del. Ch. 2008) (discussing a situation where the buyer wanted to back out of a merger after an illiquid and frozen credit market caused the buyer to lack sufficient funds to close the transaction).

93. *See id.*

94. *Id.* at 721.

95. *Id.*

96. *Id.*

97. *Id.* at 722.

98. Gilson & Schwartz, *supra* note 7, at 330, 340, 350, 354–55 (observing that carveouts to the MAE/MAC definition are typically limited to the buyers and sellers in the technology

IBP, where the parties agreed to a traditional MAE/MAC, in *Hexion* the parties negotiated a "narrowly tailored" MAE/MAC definition.[99] The MAE/MAC agreed to in the Hexion transaction included a number of carveouts subject to disproportionate-effects language (semi-endogenous risks). The carveout that was most directly relevant to the litigation was the disproportionate-effect analysis of the carveout that excluded changes in general economic or financial market conditions as well as any changes in the chemical industry generally.[100]

In considering Hexion's claim, Vice Chancellor Lamb did three things. First, the court reiterated, as in *IBP*, that the question of whether or not an adverse event is an MAE/MAC must be evaluated against an assumption that the buyer is buying the target as part of a long-term strategy measured in years, not months.[101] The burden of demonstrating the long-term adverse effect sits with the buyer who is seeking to escape performance of the merger contract.[102] Second, the court made it clear that in order to evaluate

sector); *see* Michael J. Halloran & D. Stanley Rowland, *Changes in Material Adverse Change Provisions in High Tech Deals*, M&A LAW., Mar. 1999 ("More exceptions are being grafted onto [MAC] provisions because of the high volatility experienced in stock trading prices and in economic and market conditions . . . .").

99. *Hexion*, 965 A.2d at 724.

100. Agreement and Plan of Merger Among Hexion Specialty Chemicals, Inc., Nimbus Merger Sub Inc., and Huntsman Corporation (Form 8-K, Exhibit 2.1), § 3.1(a)(ii) (July 12, 2007), https://www.sec.gov/Archives/edgar/data/1307954/000110465907053855/a07-18690_3ex2d1.htm [https://perma.cc//CK9G-X7WJ] (defining the "Company Material Adverse Effect" 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, (C) the outbreak or escalation of hostilities involving the United States, the declaration by the United States of war or the occurrence of any natural disasters and acts of terrorism, except in the event, and only to the extent, of any damage or destruction to or loss of the Company's or its Subsidiaries' physical properties . . . .").

101. *Hexion*, 965 A.2d at 738.

102. *Id.* ("This, of course, is not to say that evidence of a significant decline in earnings by the target corporation during the period after signing but prior to the time appointed for closing is irrelevant. Rather, it means that for such a decline to constitute a material adverse

the MAE/MAC carveouts, the court must first determine that there had been a MAE/MAC under the traditional MAE/MAC definition.[103] Third, the court must then analyze whether the adverse shock has disproportionately affected the target company relative to the industry in which the target operated in order to determine whether the adverse shock was semi-endogenous and therefore not subject to the negotiated carveouts.[104] Although Huntsman was not performing as well as others in the same industry following the onset of the global financial crisis of 2008, the court determined that the financial crisis did not reach the level of a traditional MAE/MAC as defined, and thus the MAE/MAC was not triggered.[105]

Rather than play the role of a force majeure clause as described in *IBP*, in *Hexion* the court explicitly recognized the new risk-allocation role of modern MAE/MAC clauses, assigning exogenous risks to the buyer and endogenous and semi-endogenous risks to the target.

C. Akorn v. Fresenius

Akorn represents a watershed moment with respect to MAE/MAC clauses.[106] *Akorn* represents the first, and only, case where a court has found there to be an adverse event sufficient to meet the definition of a MAE/MAC to permit a buyer to walk away from the transaction.[107] In *Akorn*, the court held, among other things, that (1) target company Akorn's sudden and sustained drop in business performance constituted an MAE; and (2) Akorn's representations regarding regulatory compliance were not true and

effect, poor earnings results must be expected to persist significantly into the future.").

103. *Id.* at 739–40.

104. *Id.* at 737 ("The plain meaning of the carve-outs found in the proviso is to prevent certain occurrences which would otherwise be MAE's being found to be so. If a catastrophe were to befall the chemical industry and cause a material adverse effect in Huntsman's business, the carve-outs would prevent this from qualifying as an MAE under the Agreement. But the converse is not true—Huntsman's performance being disproportionately worse than the chemical industry in general does not, in itself, constitute an MAE. Thus, unless the court concludes that the company has suffered an MAE as defined in the language coming before the proviso, the court need not consider the application of the chemical industry carve-outs.").

105. *Id.* at 721, 743.

106. Akorn, Inc. v. Fresenius Kabi AG, C.A. No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325 (Del. Ch. Oct. 1, 2018).

107. *See id.*

correct, and that this deviation would reasonably be expected to result in an MAE.[108]

In *Akorn*, not long after the parties signed the merger agreement, the buyer started to receive anonymous whistleblower accounts from an employee of Akorn alerting it to ongoing fraud involving Akorn's director of quality assurance.[109] The allegations were that the director was embezzling from the company by submitting expenses for quality tests that were never undertaken.[110] Worse, statements that the company had undertaken these phantom quality assurance tests were submitted to the FDA as part of the approval process for Akorn's candidate drugs.[111] Submission of false data to the FDA obviously called into question the entire approval process for all the affected drug candidates.[112] In response to the whistleblower allegations, Akorn approached the FDA and "downplayed its problems and oversold its remedial efforts" in a misleading presentation to the agency.[113] In addition, a few days after the parties signed the merger agreement, Akorn's business "dropped off a cliff," leading to an initial decline in revenues of more than 25% followed by continued declines in business performance due to loss of an important contract as well as unexpected new competition.[114] The court observed that Akorn's year-over-year quarterly decline in revenue, operating income, and EPS had all deteriorated significantly during the pre-closing period.

YEAR-OVER-YEAR CHANGE IN AKORN'S PERFORMANCE[115]					
	Q2 2017	Q3 2017	Q4 2017	FY 2017	Q1 2018
Revenue	(29%)	(29%)	(34%)	(25%)	(27%)
Operating Income	(84%)	(89%)	(292%)	(105%)	(134%)
EPS	(96%)	(105%)	(300%)	(113%)	(170%)

108. *Id.* at *109–10.
109. *Id.* at *62.
110. *Id.* at *63–64.
111. *Id.*
112. *Id.* at *151–53.
113. *Id.* at *6.
114. *Id.* at *126–28, *242 tbl.4.
115. *Id.* at *242 tbl.4.

After a trial, the Chancery Court found that the causes of Akorn's declining performance were material and durationally significant as the decline had already persisted for at least a year and showed no signs of abating.[116] Although Akorn pointed to industry headwinds as the reasons for its poor performance, the company vastly underperformed compared to any of its competitors in the industry.[117] The court found that even if the material adverse effect was subject to a carveout, it was semi-endogenous and thus not carved out from the MAE definition. The disproportionate impact of any economic headwinds on Akorn suggested that the problems exemplified by the downturn were specific to the company.[118]

The court also identified a MAE/MAC stemming from Akorn's problems with regulatory compliance.[119] The parties had agreed to a representation in the merger agreement that Akorn had been in compliance with all applicable law, including regulatory compliance, subject to a MAE qualifier.[120] To the extent any compliance failure resulted in a MAE, the representation would fail to be true and accurate at closing, and generate a separate right by the buyer to walk away.[121] In fact, at trial Fresenius established that Akorn's regulatory difficulties were of such qualitative and quantitative significance—causing the FDA to review each and every affected drug candidate—that the effect on Akorn's business was material and durationally significant when viewed from the long-term perspective of a reasonable acquirer, thus creating a second basis upon which the buyer could walk away from the transaction.[122]

116. *Id.* at *126–27.
117. *Id.* at *133, *136 n.616.
118. *Id.* at *134–37.
119. *Id.* at *109–10.
120. *See id.* at *43–45.
121. *See id.* at *183–84, *183 n.761.
122. *Id.* at *193. In a subsequent case, *Channel Medsystems v. Boston Scientific*, the parties were faced—oddly enough—with a similar set of facts. Improprieties with the quality assurance program at Channel Medsystems led them to submit false reports to the FDA. Citing *Akorn*, Boston Scientific sought to terminate the merger agreement. However, the structure of the Channel Medsystems agreement was different. The agreement was structured as an option. In the event Channel Medsystems received approval for its candidate drugs by March 2019, then Boston Scientific would be required to complete the purchase. In effect, the court was not required to make a ruling on whether the identified improprieties rose to the level of a MAE. If the seller could cure the improprieties with the FDA prior to the March trigger, then, by definition, the improprieties would not be material adverse events and the buyer would be required to close on the transaction. If, on the other hand, the improprieties caused the FDA to balk on approval and the March trigger was missed,

Although in many areas of the common law an accumulation of a large number of cases with various factual scenarios is required to distill the view of the court, the opposite has been true with respect to the development of the MAE/MAC jurisprudence. Although the MAE/MAC may appear vague, courts, with a single exception, have uniformly ruled that the factual scenarios typically presented by buyers do not represent a MAE/MAC sufficient to trigger a walk right. Absent adverse endogenous and semi-endogenous events during the executory period, the modern MAE/MAC locks buyers into completing transactions. Adverse exogenous shocks are a risk that the buyer must absorb while adverse endogenous and semi-endogenous shocks are risks best left with the seller. There are sound economic reasons for turning the traditional MAE/MAC on its head and allocating the risks with the parties best able to bear or ameliorate them. Courts, for their part, have quickly adopted these rationales.

IV. RENEGOTIATIONS IN THE COVID-19 ERA

Against the backdrop of how courts evaluate MAE/MAC claims and how parties to merger agreements are using modern MAE/MACs, one can ask whether the conventional wisdom that buyers will use the MAE/MAC clauses as a lever to force a renegotiation in the event of an adverse event has any purchase. Recent experience with the COVID-19 outbreak suggests that the conventional wisdom gets this wrong. The Forescout renegotiation seems to be the exception to the rule; though it may not be at second glance. Given the relative paucity of renegotiations and court actions, parties to the merger agreements appear to understand that the modern MAE/MAC does not function in response to situations like the COVID-19 outbreak as a force majeure clause to facilitating renegotiations. Rather, it appears that market participants have internalized and operationalized the view that the modern MAE/MAC acts to apportion risk between buyer and seller, with risk of adverse exogenous events borne by the buyer and the risk of adverse endogenous events borne by the seller. In that sense, the

then the buyer would be under no obligation to complete the purchase. In any event, the seller was able to cure, and the court found that there had not been a MAE. *See* Channel Medsystems, Inc. v. Boston Sci. Corp., C.A. No. 2018-0673-AGB, 2019 Del. Ch. LEXIS 1394, at *12, *16, *32, *39–40, *71, *73 (Del. Ch. Dec. 18, 2019).

worldwide COVID-19 outbreak is an archetypal exogenous adverse shock, the cost of which must be borne by the buyer.

Of course, it is entirely true that in the wake of the COVID-19 outbreak targets in pending transactions may well be considerably less valuable to buyers over the long term than they were prior to COVID-19. It is also likely true that buyers may wish to renegotiate the terms of their pending merger agreements or even cancel them altogether. However, doing so would require the seller—who will have no control over the operation of the business into the future—rather than the buyer to bear the cost of a durationally significant, exogenous event. At the same time, the modern MAE/MAC does not provide a credible lever for buyers to push the cost of a worldwide pandemic onto the shoulders of sellers rather than to leave those costs where they had been agreed to rest, on the shoulders of buyers.

The recent experience of LVMH–Tiffany presents a salient example. The original merger agreement was agreed to on November 24, 2019, in advance of the pandemic.[123] The agreement included a modern MAE/MAC with extensive carveouts and disproportionate-effect language covering semi-endogenous risks. The agreement did not, however, include a specific carveout for pandemics.[124] Following the COVID-19 outbreak, the luxury retail business is facing what can only be described as adverse shock. Although LVMH considered whether to declare a MAE/MAC under the terms of the agreement and either terminate or renegotiate the price, it declined to do either. Rather, in September 2020, LVMH announced that it would permit the deal to hit the outside date and expire on November 24, 2020, following a request by French authorities to delay the closing of the deal until after January 6, 2021.[125] Following a declaratory action brought against it by the seller, LVMH

123. Agreement and Plan of Merger By and Among Tiffany & Co., LVMH Moet Hennessy-Louis Vuitton SE, Breakfast Holdings Acquisition Corp., and Breakfast Acquisition Corp. (Form 8-K, Exhibit 2.1) (Nov. 24, 2019) [hereinafter LVMH–Tiffany Merger Agreement], https://www.sec.gov/Archives/edgar/data/98246/000119312519299997/d840067dex21.htm [https://perma.cc/YU36-VFWQ].

124. The "acts of God" carveout, which would typically include the pandemic carveout, included only carveouts for "hurricane, tornado, flood, earthquake or other natural disaster." *Id.* § 1.1. Arguably, a pandemic might fall under the general rubric of a natural disaster.

125. Andrea Felsted, *LVMH Finds a Convenient Excuse to Dump Tiffany*, BLOOMBERG (Sept. 9, 2020, 8:05 AM), https://www.bloomberg.com/opinion/articles/2020-09-09/lvmh-finds-a-convenient-excuse-to-dump-tiffany [https://perma.cc/D9A3-E9V8].

filed a countersuit in which it argued that there had been a MAE/MAC despite initially declining to declare a MAE/MAC and attempting to walk away.[126]

LVMH's argument was three-fold. First, it argued that COVID-19 was a material adverse event that had not been carved out from the agreement.[127] LVMH argued that Tiffany could have sought a specific carveout against the occurrence of a pandemic but did not.[128] Therefore, Tiffany should bear the cost of the subsequent occurrence of this unforeseeable exogenous event. Of course, to the extent courts believe the economic rationale for modern MAE/MAC clauses, this reasoning is unsatisfying. There is no particular reason to believe that Tiffany's, rather than the buyer, is in a better position to ameliorate the ongoing effects of a global pandemic. To rule for LVMH would merely reward the buyer for its good fortune that the exogenous adverse shock happened not to be on its enumerated list of carveouts. LVMH's second argument, one with perhaps more purchase, was that even if the COVID-19 pandemic is covered as an act of God, it was a semi-endogenous risk, the cost of which should properly be allocated to Tiffany and not LVMH.[129] As evidence, LVMH pointed to the poor performance of shopping malls and tourist destinations, which LVMH argued were responsible for a significant portion of Tiffany's sales.[130]

LVMH's final argument was not related to the MAE/MAC at all. LVMH argued that when Tiffany's shut its retail operations in response to the government-mandated shutdowns across the country, it nevertheless continued to pay its regular dividend rather than conserve cash. LVMH's argument was, in effect, that in response to the COVID-19 outbreak the "ordinary course" covenant required Tiffany's to conserve cash rather than to continue to pay it in the form of dividends.[131]

Ultimately, the parties renegotiated the terms of the merger agreement rather than proceeding to litigation. However, the terms of the renegotiation suggest it was more of a fig leaf than a

126. LVMH's Verified Counterclaim and Answer to Verified Complaint, *supra* note 10, at 1–2.

127. *Id.* at 2.

128. *Id.*

129. *Id.* at 3.

130. *Id.*

131. *Id.* at 9.

substantive reapportionment of the costs of the pandemic. First and foremost, the parties agreed to reduce the price term from $135/share to $131.50/share, a 2.6% reduction.[132] It is hard to argue that a 2.6% reduction in value represents a material redistribution of the risk associated with the ongoing COVID-19 outbreak. This price reduction was not costless to the buyer, however. In exchange for a price reduction, the seller received a number of valuable changes to the terms of original agreement. These included a specific agreement to permit Tiffany's to make dividend payments to its shareholders, as well as an agreement that, in the event Tiffany's must go to court to seek performance of the merger agreement again, the merger consideration for purposes of determining damages would revert to $135/share.[133] In addition, the amended merger agreement removed a number of conditions to the merger, including the absence of a legal constraint to closing which might permit LVMH to refrain from closing if there was an order enjoining the agreement (one such purported order from the government of France was at issue in the litigation).[134] Finally, the parties redefined "Material Adverse Effect" in the amended agreement. The amended definition specifically carved out any COVID-19-related risks, thus placing COVID-related risks squarely on the shoulders of the buyer.[135] In short, after LVMH refused to close its acquisition of Tiffany, pointing to the global pandemic, it ultimately agreed to a face-saving, modest price reduction while giving the seller additional closing certainty and assurance that in the event of further buyer backsliding the seller would be permitted to recoup the original merger consideration should a court be forced to award damages.

In another COVID-19 MAE/MAC case before the Delaware Chancery Court, *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*,[136] Vice Chancellor Laster was asked to rule when Mirae Asset Daewoo Co. and affiliates from South Korea sought to walk

132. Amended and Restated Agreement and Plan of Merger By and Among Tiffany & Co., LVMH Moet Hennessy-Louis Vuitton SE, Breakfast Holdings Acquisition Corp., and Breakfast Acquisition Corp. (Form 8-K, Exhibit 2.1) (Oct. 28, 2020) [hereinafter LVMH–Tiffany Amended Merger Agreement], https://www.sec.gov/Archives/edgar/data/98246/000119312520280456/d91099dex21.htm [https://perma.cc/KH8V-DZBP].

133. *Id.* § 10.6.

134. Tiffany & Co., Current Report (Form 8-K) (Oct. 28, 2020).

135. LVMH–Tiffany Amended Merger Agreement, *supra* note 132, § 1.1.

136. AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC, C.A. No. 2020-0310-JTL, 2020 Del. Ch. LEXIS 353 (Del. Ch. Nov. 30, 2020).

away from an agreement to purchase certain assets from Chinese Anbang Insurance Group. Mirae made two arguments related to COVID-19. First, that the buyer was not required to close because COVID-19 amounted to a MAE/MAC, causing the bringdown condition to fail. Second, that in response to COVID-19, the Anbang Group made significant changes in its hotel business during the executory period and thus violated its covenant to run the business in the ordinary course between signing and closing.[137]

With respect to the first issue, Vice Chancellor Laster found that, notwithstanding the fact that the parties had not negotiated for a specific "pandemic" carveout, the carveout for "natural disasters and calamities" was sufficiently broad to cover a naturally occurring global pandemic. Thus, while COVID-19 might be a MAE/MAC, the risk of a pandemic occurring during the executory period was an exogenous risk that properly fell on the shoulders of the buyer. Consequently, Mirae could not refuse to close on account of a MAE/MAC since the bringdown condition had not failed.[138]

With respect to Mirae's ordinary-course argument, however, the court felt differently. Buyer argued that when Anbang made material changes to the operations of its businesses in response to the pandemic, the company breached its obligation to run the business in the ordinary course consistent with past practice. Anbang argued that it ran the business in the ordinary course given the current circumstances. The court found that the buyer had the better of this argument and ruled that seller had breached its ordinary course, thus permitting the buyer to refuse to close the transaction.[139]

Similarly, Sycamore Partners sought to terminate its February 20, 2020, merger agreement with L Brands to acquire Victoria's Secret. Although Sycamore considered renegotiating the merger agreement, it sued to terminate the merger agreement after efforts to renegotiate were rebuffed by L Brands.[140] In its suit, Sycamore

137. *Id.* at *1.
138. *Id.* at *48.
139. *Id.*
140. James B. Stewart, *The Victoria's Secret Contract That Anticipated a Pandemic*, N.Y. TIMES (Apr. 29, 2020), https://www.nytimes.com/2020/04/29/business/victorias-secret-sycamore-coronavirus.html [https://perma.cc/523R-LTV8].

did not attempt to argue that COVID-19 was a MAE/MAC.[141] Presumably, by February 20, 2020, the prospect of a global pandemic was reasonably foreseeable to the parties. The parties had specifically included a carveout for pandemics in their definition of MAE/MAC.[142] Although that avenue was contractually available to Sycamore, it sought a declaratory judgment against L Brands for violating its "ordinary course" covenant because it ceased doing business in the ordinary course as the economy shut down, relying on the same argument that would eventually be successful in *Mirae*.[143] Ultimately, L Brands and Sycamore agreed to terminate the merger agreement without further renegotiation on the price term or litigation.[144]

The sudden and unexpected deceleration of economic activity in the spring and summer of 2020 (including a 33% drop in annualized GDP in the second quarter of 2020) was not only dramatic, but it had painful consequences that will likely persist for many years to come.[145] If COVID-19 is not a material adverse event, then likely nothing is. Nevertheless, only a small number of transactions (three) took the opportunity to back away from negotiated terms and reprice their agreements. The few that did appear to be the exception rather than the rule. In addition to L Brands (Victoria's Secret), only three of 258 transactions announced from January 2018 to June 2020 agreed to mutually terminate their merger agreements.[146] Indeed, more transactions appear to have been outright cancelled (four) than have been renegotiated in response to COVID-19.[147] The relative paucity of renegotiations following

141. *See* Verified Complaint, SP VS Buyer LP v. L Brands, Inc., No. 2020-0297, 2020 WL 1970736 (Del. Ch. Apr. 22, 2020).

142. Transaction Agreement Between SP VS Buyer LP and L Brands, Inc. (Form 8-K, Exhibit 2.1), § 1.01 (Feb. 20, 2020), https://www.sec.gov/Archives/edgar/data/701985/000095010320003347/dp121693_ex0201.htm [https://perma.cc/WE28-HUNA].

143. Verified Complaint, *supra* note 141, at 1–4.

144. Carleton English, *L Brands, Sycamore Partners Reach 'Mutual Agreement' Terminating Sale of Victoria's Secret*, BARRON'S (May 4, 2020, 5:22 PM), https://www.barrons.com/articles/l-brands-sycamore-partners-abandon-victorias-secret-deal-51588627374 [https://perma.cc/7XR5-CL9L].

145. Jeff Cox, *Second-Quarter GDP Plunged by Worst-Ever 32.9% Amid Virus-Induced Shutdown*, CNBC (Jul. 30, 2020, 8:31 AM), https://www.cnbc.com/2020/07/30/us-gdp-q2-2020-first-reading.html [https://perma.cc/27A2-9CHG].

146. Review of Merger Agreements Between January 2018 & June 2020 Valued at $500 Million or Greater (on file with author).

147. *See* Press Release, Hexcel, Woodward and Hexcel Announce Mutual Termination of Merger Agreement (Apr. 6, 2020), https://investors.hexcel.com/investor-news/news-details/2020/Woodward-and-Hexcel-Announce-Mutual-Termination-of-Merger-Agreement/default.

COVID-19 does not suggest that the pandemic has not had an adverse effect on the business prospects of merger targets. In fact, across most industries it most certainly has. However, it does raise the question of why so few merger agreements have been subject to a renegotiation, especially if the conventional wisdom suggests that parties will often use the opportunity of an adverse shock to pursue a renegotiation of terms.

A. *Why So Few Renegotiations?*

The conventional wisdom with respect to MAE/MACs is that, when faced with an adverse event, buyers will act opportunistically to renegotiate the terms of a pending merger agreement because there is sufficient ambiguity around whether a buyer will be successful in litigation to make any threat to withdraw from the merger agreement credible. However, two things have happened since *IBP*. First, contracting practices have changed over time. At the time *IBP* was decided, the traditional MAE/MAC was prevalent in merger contracting. Indeed, at issue in *IBP* itself was a traditional MAE/MAC. The traditional MAE/MAC is more akin to a traditional force majeure contract, however, because it is so broadly drafted. The traditional MAE/MAC engenders a good deal of ambiguity, which Vice Chancellor Strine identified as a feature, not a bug. Where there are few or no carveouts to the MAE/MAC definition, there will be a high degree of ambiguity about what might or might not constitute a material adverse event for purposes of permitting the buyer to terminate a transaction or decline to close a deal.

aspx [https://perma.cc/R6NN-WN5V] ("The termination . . . is in response to the increasing impact on both the aerospace and industrial sectors, and global markets broadly, resulting from the health crisis caused by the coronavirus (COVID-19) pandemic."); Press Release, NASDAQ, Stein Mart and Kingswood Announce Mutual Termination of Merger Agreement (Apr. 16, 2020), https://www.nasdaq.com/press-release/stein-mart-and-kingswood-announce-mutual-termination-of-merger-agreement-2020-04-16 [https://perma.cc/G2L6-Y3ME] ("The termination . . . is in response to the unpredictable economic conditions resulting from the global health crisis caused by the coronavirus (COVID-19) pandemic, uncertainty regarding Stein Mart's ability to satisfy the conditions to closing, and the substantial expense to Stein Mart of soliciting shareholder approval for a transaction which is unlikely to close."); *Texas Capital Bancshares, Inc. Announces Mutual Agreement to Terminate Proposed Merger With Independent Bank Group, Inc.*, YAHOO! FIN. (May 26, 2020), https://finance.yahoo.com/news/texas-capital-bancshares-inc-announces-110010372.html [https://perma.cc/YU88-8TU5] (stating that the termination was due to "the significant impact of the COVID-19 pandemic on global markets and on the companies' ability to fully realize the benefits they expected to achieve through the merger.").

Where the MAE/MAC is deployed in its traditional form without carveouts, the attendant high degree of ambiguity gives rise to incentives to litigate and therefore renegotiate in the face of an adverse event, even if the event is not obviously a MAE/MAC. This is consistent with the conventional wisdom with respect to how parties to a merger agreement will manage pre-closing adverse shocks.

However, over time, contracting practices have changed, and the work that the MAE/MAC does has changed as well. Rather than act as a force majeure/frustration clause, the MAE/MAC has taken on an altogether different role. The effect of the carveouts and disproportionate-effect language has flipped the MAE/MAC on its head. No longer does the MAE/MAC permit the buyer to terminate a merger contract due to a force majeure event. In fact, the buyer is required to close the transaction in spite of force majeure events given the modern MAE/MAC formulation. Rather, the modern MAE/MAC only permits the buyer to terminate the merger contract in the event an adverse shock endogenous to the seller occurs between signing and closing (as in *Akorn*).

A study from 1998–2005 found that 9% of transactions in the study sample suffered a MAE/MAC. MAE/MAC clauses in that study were mostly traditional MAE/MAC clauses or had few carveouts. These traditional MAE/MAC clauses, or slim MAE/MAC clauses, were responsible for 80% of all deal renegotiations leading to reductions in deal prices that averaged 15%.[148] The conventional wisdom suggests that following the COVID-19 outbreak, buyers should take the opportunity to renegotiate terms of transactions to reflect new, lower valuations, like they did during the 1998–2005 period. However, there have been relatively few such renegotiations. The reasons for this may be twofold. First, parties who seek to renegotiate systematically overestimate litigation costs as well as the likelihood of successfully arguing an exogenous event like COVID-19 is an adverse event within the definition of a modern MAE/MAC. Consequently, buyers and sellers who do not renegotiate understand that threats to litigate lack credibility because buyers are extremely unlikely to succeed. Absent a credible threat of buyer contract failure, sellers appear willing to force buyers to accept even inefficient transactions that represent a net loss in terms

148. Denis & Macias, *supra* note 23, at 819–21 (finding that MACs are responsible for 80% of renegotiations of merger agreements).

of transaction surplus and distribution of rents to the seller rather than to agree to share the cost of losses during the executory period. Second, the modern MAE/MAC has a very different role in the merger agreement. Over time, what started as a force majeure/frustration clause has flipped on its head to more tightly commit a buyer to complete a transaction by drastically narrowing the scope of permissible excuse from performance.

In the context of a traditional MAE/MAC, a pandemic like COVID-19 is an axiomatic adverse event, and thus should be a credible lever to force a renegotiation. However, given the fundamental transformation of the role of the MAE/MAC clause in merger agreements since the landmark 2001 MAE/MAC case, *IBP*, this is no longer the case. The MAE/MAC at issue in *IBP*, consistent with the time, was a traditional MAE/MAC with no carveouts. Vice Chancellor Strine observed that such a "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."[149] He also prognosticated that interpreting a traditional MAE/MAC in any other manner would "encourage the negotiation of extremely detailed 'MAC' clauses with numerous carve-outs or qualifiers. An approach that reads broad clauses as addressing fundamental events that would materially affect the value of a target to a reasonable acquiror eliminates the need for drafting of that sort."[150] However, subsequent development of the MAE/MAC clause in practice suggests the Vice Chancellor got that exactly backwards. The inherent vagueness of a broadly written traditional MAE/MAC creates an incentive for parties to transform MAE/MAC terms from a broad, buyer-friendly force majeure/frustration clause to a provision that allocates exogenous risk explicitly to the buyer.

The structure of MAE/MAC clauses deployed prior to *IBP* suggests that MAE/MAC clauses were still playing the role of force majeure/frustration clauses at that time. Given that exogenous events are captured within the definition of force majeure clauses, there is significant indefiniteness about what may constitute a MAE/MAC. Consequently, traditional MAE/MAC clauses are a

149. *In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 68 n.155 (Del. Ch. 2001).
150. *Id.*

credible lever for forcing renegotiations, even inefficient renegotiations that impose the costs of adverse exogenous events on sellers. However, since *IBP* in 2001, practice has transitioned away from the traditional MAE/MAC towards a broad adoption of modern MAE/MAC clauses with their extensive use of carveouts.[151]

Very few, if any, merger agreements now rely on traditional MAE/MACs. This represents a dramatic transformation of the MAE/MAC clause over the past two decades.[152] The modern MAE/MAC, with its large number of carveouts, is a relatively recent development. For example, in the classic 1975 tome on merger agreements *Anatomy of a Merger* by James Freund, there is barely a passing reference to the role of MAE/MAC clauses.[153] The 2001 ABA Model Asset Purchase Agreement, which acts as a template for many practicing lawyers, proffers a traditional definition of a MAE/MAC for its model agreement.[154] The salient points for discussion for the model agreement relate not to carveouts or semi-endogenous risks, but to whether or not the addition of "prospects" to the traditional definition of a MAE/MAC is appropriate. The commentary to the Model Agreement suggests that sellers may attempt to negotiate one or more of the following carveouts:

> (i) any change resulting from conditions affecting the industry in which Seller operates or from changes in general business or economic conditions; (ii) any change resulting from the announcement or pendency of any of the transactions contemplated by this Agreement; or (iii) any change resulting from compliance by Seller with the terms of,

151. This phenomenon is consistent with the observation by Professor Jennejohn of "mass customization" of merger agreements within merger practice. Matthew Jennejohn, *The Architecture of Contract Innovation*, 59 B.C. L. REV. 71, 72 (2018). Professor Mitu Gulati et al. also observe similar phenomena with respect to the development of the use of specific-performance provisions in merger agreements since 2001. *See* Theresa Arnold, Amanda Dixon, Hadar Tanne, Madison Sherrill & Mitu Gulati, *Lipstick on a Pig: Specific Performance Clauses in Action*, __ WIS. L. REV. __ (forthcoming 2021).

152. The phenomenon of contractual innovation, particularly with respect to the development of merger agreements, has been the subject of a good deal of recent serious study. *See, e.g.*, Jennejohn, *supra* note 151, at 72–73; Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NW. L. REV. 279 (2018); Robert Anderson & Jeffrey Manns, *The Inefficient Evolution of Merger Agreements*, 85 GEO. WASH. L. REV. 57 (2017); Stephen J. Choi, Mitu Gulati & Robert E. Scott, *The Black Hole Problem in Commercial Boilerplate*, 67 DUKE L.J. 1 (2017); John C. Coates, IV, *Why Have M&A Contracts Grown? Evidence from Twenty Years of Deals* (Harvard Law Sch. John M. Olin Ctr., Discussion Paper No. 889, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2862019 [https://perma.cc/VU9F-QZQT].

153. JAMES C. FREUND, ANATOMY OF A MERGER 259–61 (1975) (discussing the "Absence of Certain Changes" representation).

154. MODEL ASSET PURCHASE AGREEMENT WITH COMMENTARY § 3.15 (AM. BAR ASS'N 2001).

> or the taking of any action contemplated or permitted by, this Agreement.[155]

Indeed, the commentary suggests that, if a buyer agrees to one or more of these proposed carveouts, the buyer should insist that the carveout be subject not to the now-common disproportionate-effect language but to a "standard of proof" that the adverse change "was proximately caused by one of the circumstances" described in the carveout.[156]

In their 2001 article, Professors Gilson and Schwartz observed the beginnings of a shift in contracting practice away from the traditional MAE/MAC. In the merger contracts they identified from 1993, only 18.33% included one or two carveouts from the traditional MAE/MAC definition; more than half identified only one carveout.[157] In 1995, 31.7% of the transactions Gilson and Schwartz identified included more than one carveout.[158] By 2000, they identified carveouts in 83% of transactions in their dataset, with an average of only 3.75 carveouts per transaction.[159] Consistent with their view that assignment of exogenous risk to the buyer is an efficient device to mitigate seller moral hazard, Professors Gilson and Schwartz argued that the use of carveouts should be concentrated in technology acquisitions where information asymmetries between buyer and seller are more obvious.[160] However, subsequent developments suggest more widespread acceptance of MAE/MAC carveouts. A 2012 MAE/MAC study by Professors Denis and Macias, relying on data from 1998–2005, observed that the vast majority of merger agreements had few, if any, carveouts from the MAE/MAC definition.[161] Professors Denis

155. *Id.* § 3.15 cmt.

156. *Id.* (responding to the criticism of the MAE/MAC as being a vague contract term).

157. Gilson & Schwartz, *supra* note 7, at 350.

158. *Id.*

159. *Id.*

160. *Id*. at 350, 354. Kenneth Adams also observed in 2004 that the extensive use of carveouts to MAEs was common in technology-sector acquisitions but not broader. *See* Adams, *supra* note 32, at 43–45.

161. Denis & Macias, *supra* note 23, at 825. Denis and Macias document the presence of MAE/MACs and carveouts in merger agreements in their sample:

and Macias's data included no MAE/MAC clauses with carveouts for pandemics, force majeure, or acts of God.[162]

By 2019, there was a near-complete transition away from the traditional MAE/MAC and adoption across all sectors of M&A practice of modern MAE/MAC clauses. Survey data from 2019 of U.S. public company deals greater than $1 billion found that MAE/MAC clauses had an average of more than fourteen carveouts with a high degree of uniformity across industries.[163] In addition to the increase in reliance on contracts, transition to modern MAE/MAC clauses also includes the use of disproportionate-effect language, which permits consideration of an exogenous effect otherwise excluded by a carveout if it disproportionately affects the target. Survey data in 2009 and 2010 saw 48% and 40% of transactions relying on such language. In 2019, 87% of public company transactions included disproportionate-effect language.[164] Similarly, 2019 survey data showed that 82% of public deals larger than $1 billion included carveouts for acts of God and 19% included carveouts for calamities.[165] Professors Jennejohn, Nyarko, and Talley conducted a review of over 1700 transactions between 2003 and 2020 for incidence of carveouts related to pandemics.[166] Although they found the incidence of a specific carveout for pandemics to be relatively low, they noted a trend over time to increase the number

Year	% with MAE/MAC	% with Carveouts	Aver Carveouts
1998	100.00%	60.4%	2.8
1999	98.8%	61.1%	2.7
2000	99.2%	75.6%	3.8
2001	97.9%	85.4%	4.4
2002	100.0%	90.9%	5.4
2003	100.0%	93.4%	5.3
2004	100.0%	91.4%	6.0
2005	100.0%	97.7%	7.2
Total	99.3%	75.6%	4.0

162. *Id.*

163. NIXON PEABODY, MAC SURVEY: NP 2019 REPORT 7 (2019), https://www.nixonpeabody.com/-/media/Files/PDF-Others/mac-survey-2019-nixon-peabody.ashx?la=en [https://perma.cc/Y77B-E7PB].

164. *Id.* at 4.

165. *Id.* at 9.

166. Matthew Jennejohn, Julian Nyarko & Eric Talley, *COVID-19 As a Force Majeure in Corporate Transactions* 1–3 (Columbia Law & Econ., Working Paper No. 625, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3577701 [https://perma.cc/N7DG-N2NW].

of carveouts, including carveouts for pandemics. By 2019, they found that 23% of transactions in their sample included carveouts for pandemics.[167]

This author's own review of merger agreements with Delaware target corporations signed between January 2018 and June 2020 valued at least $500 million produced a broad sample of MAE/MAC clauses, including a number that covered the period after COVID-19 entered the world stage. Many of the MAE/MAC clauses include carveouts directly or reasonably applicable to the COVID-19 outbreak, including carveouts for epidemics or pandemics, national emergencies, as well as carveouts covering force majeure generally. The use of disproportionate-impact language to carve-in pandemics in the event the impact on the target was disproportionate to the industry in which the target operates was nearly universal.

COVID-19 RELATED CARVEOUTS	
Epidemic (and variations)	67 (25.9%)
Force Majeure	120 (46.5%)
National Emergency	17 (6.6%)
Disproportionate-Impact Language	254 (98.4%)

Where the merger agreement includes a pandemic, national emergency, act of God, or other force majeure event as a carveout, the occurrence of such an event, without more, would not be permitted to form the basis of a claim that there has been an MAE/MAC unless the target is disproportionately affected by the pandemic.

The transition from traditional MAE/MAC clauses with few, if any, carveouts to modern MAE/MAC clauses with many carveouts and disproportionate-effects language was relatively rapid. Following *IBP*, what had been a niche contracting practice of including a large number of carveouts, limited mostly to technology company acquisitions, became much more diffuse and was adopted by merger agreements across all sectors.[168] The effect of this shift was to

167. *Id.* at 5 (Finding that, in part, the relatively low number of pandemic carveouts can be tied to a lack of salience).

168. In their study of the evolution of merger agreements, Professors Anderson and

turn the MAE/MAC clause on its head. Traditional MAE/MAC clauses leave the risk of most durationally significant, exogenous, adverse events with sellers rather than buyers. On the other hand, the addition of carveouts and disproportionate-effects language shifts the risk of exogenous adverse events onto buyers and leaves the risk of only endogenous and semi-endogenous events with the seller.

By any measure, the MAE/MAC that LVMH and Tiffany negotiated in their agreement is an example of a modern MAE/MAC. LVMH and Tiffany included nine specific carveouts to their definition of a MAE/MAC, including specific carveouts against changes in "general economic or political conditions," against "any change in Law applicable to the Company's business," against the occurrence of "any hurricane, tornado, flood, earthquake, or other natural disaster," as well as specific carveouts against adverse effects attributable to

> geopolitical conditions, the outbreak or escalation of hostilities (including the Hong Kong protests and the "Yellow Vest" movement [in France]), any acts of war (whether or not declared), sabotage (including cyberattacks) or terrorism, or any escalation or worsening of any such acts of hostilities, war, sabotage, or terrorism threatened or underway . . . ."[169]

With respect to the agreement's more specific carveouts that touch on a number of salient issues known at the time of the agreement's November 24, 2019, signing (e.g., the Hong Kong protests and the Yellow Vest movement in France), the parties included carveouts to specify that those known adverse events would not come under the definition of a MAE/MAC for purposes of permitting the buyer to terminate the merger agreement. Notably, the parties did not include a specific carveout for pandemics or other acts of God in their merger agreement.[170] Arguably, general carveouts against adverse changes in economic conditions or adverse changes in laws should be sufficient to cover the effects of a pandemic on Tiffany's business. However, it does not necessarily follow

Manns argue that evolution of deal terms is path-dependent and eschews deal term standardization. The experience of the evolution of MAE/MAC clauses suggests that, at least with this term, deal term standardization and rapid evolution is certainly possible in merger agreements. Anderson & Manns, *supra* note 152, at 61.

169. LVMH–Tiffany Merger Agreement, *supra* note 123, § 1.1.

170. *Id.* at art. I.

that the parties intended to allocate exogenous pandemic risk, should it occur, to the seller.

Because the modern MAE/MAC allocates adverse endogenous risks to the seller and exogenous risks to the buyer, a more reasonable reading of a modern MAE/MAC would be one that assigns unforeseeable exogenous adverse shocks to the buyer and not the seller. Not only would this be consistent with doctrines of excuse like frustration and impracticability, which require the risk be unforeseen by the parties, but it would be consistent with current understanding of the MAE/MAC provision's purpose.[171]

While the appearance of pandemics like COVID-19 from time to time is entirely foreseeable, their actual appearance is stochastic and obviously not within the control of either buyer or seller. The pandemic is, in that sense, the archetypical exogenous event. Allocating the risk of a pandemic to a target because the parties failed to specifically enumerate it on a list of carveouts is inefficient, as a buyer is in the best position to bear the cost of the appearance of a pandemic between signing and closing. It is also inconsistent with the purpose of the modern MAE/MAC provision in merger agreements. Any other result would irrationally reward a buyer who, during the executory period, is "lucky enough" to suffer a pandemic rather than any other specified exogenous risk. To the extent there remains vagueness in the modern MAE/MAC term, particularly the carveouts, parties could resolve this by being more explicit in their drafting: allocating exogenous risks to the buyer and endogenous and semi-endogenous risks to the seller. If not, then, contra Vice Chancellor Strine, drafters face an incentive to add additional carveouts to the ever-increasing list of carveouts, constrained only by the drafters' imagination.[172]

171. Akorn, Inc. v. Fresenius Kabi AG, C.A. No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325, at *133–34 (Del. Ch. Oct. 1, 2018) ("Consistent with standard practice in the M&A industry, the plain language of the Merger Agreement's definition of a Material Adverse Effect generally allocates the risk of endogenous, business-specific events to [the seller] and exogenous, systematic risks to [the buyer].").

172. Because most such carveouts will necessarily cover low-probability events, the present value to the buyer of accepting such risks should be low, e.g., carveouts for meteor strikes, etc., leading to a potential explosion in negotiated carveouts. In *Mirae*, Vice Chancellor Laster threaded the needle by ruling that "natural disaster" and "calamity" were sufficiently broad as to encompass pandemics such as COVID-19 for purposes of the carveout to the MAE/MAC. AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC, C.A. No. 2020-0310-JTL, 2020 Del. Ch. LEXIS 353, at *48 (Del. Ch. Nov. 30, 2020).

B. *When Should One Expect a Renegotiation?*

Although the crux of the conventional wisdom's argument is that the MAE/MAC gives rise to renegotiations, one must note that although an adverse shock may generate a motivation for buyers to renegotiate, buyers have extremely limited ability to generate credible threats to terminate transactions. In the past, when traditional MAE/MACs were more prevalent, every adverse shock could give rise to a potentially credible termination threat and then subsequent renegotiation. However, modern MAE/MACs presently make up the vast majority of MAE/MAC clauses in merger agreements. Consequently, adverse exogenous shocks that occur between signing and closing, like the COVID-19 outbreak, will not be of the type to generate a credible claim for a MAE/MAC. Therefore, buyer threats to terminate transactions due to adverse events like COVID-19 are not credible. To the extent a buyer threatens to terminate a transaction due to adverse exogenous shock, such a renegotiation will most likely involve the buyer forcing the seller's shareholders to bear at least some of the cost of the shock, which would be inefficient unless the shock represented a semi-endogenous risk.[173] Consequently, although the conventional wisdom suggests that the MAE/MAC provision can act as a fulcrum for renegotiation following an adverse shock during the executory period, one should not expect such renegotiations to be plentiful. To the extent there are renegotiations, one should expect they will be relatively few in number and limited to the following three categories: adverse endogenous shocks, adverse semi-endogenous shocks, and inefficient renegotiations.

Adverse Endogenous Shocks. Following *Akorn*, it is clear that there is relatively little ambiguity surrounding the interpretation of modern MAE/MAC clauses: courts will enforce them where they involve adverse endogenous and semi-endogenous shocks. Adverse exogenous shocks, like the COVID-19 outbreak, will not trigger a buyer's right to terminate and their occurrence does not generate a credible termination threat sufficient to initiate a renegotiation. On the other hand, where the seller has experienced an adverse endogenous risk between signing and closing, a buyer's claim to a MAE/MAC is credible. In such situations, both sides' positions may be improved by a renegotiation of the merger agreement's terms

173. Gilson & Schwartz, *supra* note 7, at 339.

compared to the alternative, which would have the buyer lose access to the seller and leave the seller to fend for itself—or even fail—without a transaction.[174] For example, following the announcement of its merger agreement with Verizon in 2016, Yahoo disclosed a massive data breach.[175] As a result of the data breach, Verizon threatened to declare a MAE/MAC and walk away from the transaction unless Yahoo renegotiated the terms of the sale. Verizon's threat was clearly credible. The data breach was material and it was a risk endogenous to Yahoo and no one else. The cost of the breach should properly have been borne by the seller. The subsequent renegotiation reduced the consideration to Yahoo shareholders by $350 million and the transaction moved to closing.[176]

The Akorn–Fresenius transaction involved an endogenous adverse event (disclosure of fraud internal to the target).[177] The effect of the adverse disclosure was to significantly reduce Fresenius's valuation of Akorn. Post-disclosure, Akorn was not worth nearly what had been offered. Subsequent to the disclosure, a termination threat by Fresenius should have been credible. Had Fresenius initiated a renegotiation, it would have reflected a revised valuation for Akorn and would have been efficient relative to the alternative of termination.

The Forescout–Advent renegotiation is another example of this dynamic playing out. Epidemics and pandemics were clearly carved out from the MAE/MAC definition in the merger agreement. Ultimately, COVID-19 likely did not create the circumstances that permitted a renegotiation, although the pandemic likely was responsible for the buyer reevaluating its valuation of

174. *See* Olivia Rockman & Jeff Feeley, *Akorn Seeks Bankruptcy After Failed Takeover*, BLOOMBERG (Feb. 12, 2020, 6:52 PM), https://www.bloomberg.com/news/articles/2020-02-12/akorn-pursues-sale-and-process-may-include-bankruptcy-filing [https://perma.cc/2K4P-RULJ].

175. Steven Davidoff Solomon, *How Yahoo's Data Breach Could Affect Its Deal with Verizon*, N.Y. TIMES (Sept. 23, 2016), https://www.nytimes.com/2016/09/24/business/dealbook/how-yahoos-data-breach-could-affect-its-deal-with-verizon.html [https://perma.cc/9WQ7-RQG4]; David Shepardson, *Verizon Says Yahoo Hack "Material," Could Affect Deal*, REUTERS (Oct. 13, 2016, 2:38 PM), https://www.reuters.com/article/us-verizon-yahoo-cyber-idUSKCN12D2PW [https://perma.cc/UE5S-7XE3]; Ingrid Lunden, *After Data Breaches, Verizon Knocks $350M Off Yahoo Sale, Now Valued at $4.48B*, TECHCRUNCH (Feb. 21, 2017, 8:34 AM), https://techcrunch.com/2017/02/21/verizon-knocks-350m-off-yahoo-sale-after-data-breaches-now-valued-at-4-48b/ [https://perma.cc/HB97-UY5N].

176. Lunden, *supra* note 175.

177. Rockman & Feeley, *supra* note 174.

the company. Rather, the claimed appearance of whistleblower allegations of financial improprieties represented an endogenous adverse event during the executory period. Advent's threat not to close the transaction was credible not due to the pandemic but due to the appearance of an endogenous risk. Rather than litigate, the parties renegotiated the terms, with Forescout shareholders absorbing the cost of the exogenous adverse event. To the extent the whistleblower allegations were real, this result was an efficient result for both buyer and seller, because it forced the seller to disclose otherwise private information rather than risk litigating in the manner described by Choi and Triantis.[178]

Adverse Semi-Endogenous Shocks. Similarly, adverse semi-endogenous shocks can be the credible impetus for efficient renegotiations. For example, LVMH argued that Tiffany's suffered a semi-endogenous adverse shock due to COVID-19. LVMH claimed that COVID-19 reduced Tiffany's valuation to a degree disproportionate with its peers due to the placement of Tiffany's retail locations in malls and dependence on tourism-based trade. If true, LVMH would have been in a position to credibly threaten termination or initiate an efficient renegotiation of the terms of the transaction.

Inefficient Renegotiations. While renegotiation in the face of endogenous and semi-endogenous adverse shocks will likely be efficient, there is also a category of inefficient renegotiations that are possible because the threat of buyer contract failure in response to an adverse exogenous event is credible. In such scenarios, the renegotiations are likely going to be inefficient because the buyer will force the target company's shareholders to bear the cost of the buyer's potential contract failure through a redistribution of the merger agreement's terms. For most strategic acquirors, the prospect of contract failure due to an adverse exogenous event is extremely rare. However, for financial buyers relying on thinly capitalized shell corporations at arm's length from the transaction sponsor, the prospect of contract failure due to an adverse exogenous event during the executory period that cuts off access to lender financing is not necessarily a remote prospect.[179]

178. Choi & Triantis, *supra* note 23, at 859.

179. *See* Steven M. Davidoff, *The Failure of Private Equity*, 82 S. CAL. L. REV. 481, 510–12 (2009); Brian JM Quinn, *Optionality in Merger Agreements*, 35 DEL. J. CORP. L. 789, 817–20 (2009).

CONCLUSION

Although the conventional wisdom suggests that, following adverse shocks like the worldwide COVID-19 pandemic, parties to merger agreements would have leaned on MAE/MAC provisions to preserve those agreements by renegotiating the terms, in fact, following the rapid onset of COVID-19 there was no rush to the renegotiation table by parties to merger agreements. The relative paucity of renegotiations suggests that the conventional wisdom either misunderstands the role of the modern MAE/MAC or at least overestimates the degree of ambiguity that surrounds current enforcement of the provision. Courts as well as drafters have adopted an approach that reflects the view offered by Professors Gilson and Schwartz that modern MAE/MAC provisions no longer function as force majeure clauses providing buyers the ability to walk away from transactions. Rather, modern MAE/MAC provisions allocate exogenous adverse risks to the buyer while making sellers responsible for adverse endogenous risks that might appear during the executory period.

Where adverse exogenous events appear, sellers have very strong contractual claims to enforcement of the merger agreement and consequently no incentive to pursue renegotiation of the merger terms. To the extent adverse endogenous or semi-endogenous risks present themselves during the executory period, parties still have incentives to efficiently renegotiate the contract terms and can do so. Similarly, where the buyer faces the prospect of contract failure as a result of an adverse exogenous risk, sellers may prefer renegotiating to enforcing their contract rights.

APPENDIX: REPRESENTATIVE MAE

The material adverse effect clause in Advent's February 2020 acquisition of Forescout is representative. It reads as follows:

"**Company Material Adverse Effect**" means any change, event, violation, inaccuracy, effect or circumstance (each, an "**Effect**") that, individually or taken together with all other Effects that exist or have occurred prior to the date of determination of the occurrence of the Company Material Adverse Effect, (A) has had or would reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of the Company and its Subsidiaries, taken as a whole; or (B) would reasonably be expected to prevent or materially impair or delay the consummation of the Merger, it being understood that, in the case of clause (A) or clause (B), *none of the following (by itself or when aggregated) will be deemed to be or constitute a Company Material Adverse Effect* or will be taken into account when determining whether a Company Material Adverse Effect has occurred or may, would or could occur (subject to the limitations set forth below):

> (i) changes in general economic conditions in the United States or any other country or region in the world, or changes in conditions in the global economy generally (except to the extent that such Effect has had a materially disproportionate adverse effect on the Company relative to other companies of a similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect);
>
> (ii) changes in conditions in the financial markets, credit markets or capital markets in the United States or any other country or region in the world, including (A) changes in interest rates or credit ratings in the United States or any other country; (B) changes in exchange rates for the currencies of any country; or (C) any suspension of trading in securities (whether equity, debt, derivative or hybrid securities) generally on any securities exchange or over-the-counter market operating in the United States or any other country or region in the world (except, in each case, to the extent that such Effect has had a materially disproportionate adverse effect on the Company relative to other companies of a similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect);
>
> (iii) changes in conditions in the industries in which the Company and its Subsidiaries conduct business (except to the extent that such

Effect has had a materially disproportionate adverse effect on the Company relative to other companies of a similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect);

(iv) changes in regulatory, legislative or political conditions (including the imposition or adjustment of tariffs) in the United States or any other country or region in the world (except to the extent that such Effect has had a materially disproportionate adverse effect on the Company relative to other companies of similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect);

(v) any geopolitical conditions, outbreak of hostilities, acts of war, sabotage, terrorism or military actions (including any escalation or general worsening of any such hostilities, acts of war, sabotage, terrorism or military actions) in the United States or any other country or region in the world (except to the extent that such Effect has had a materially disproportionate adverse effect on the Company relative to other companies of similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect);

(vi) earthquakes, hurricanes, tsunamis, tornadoes, floods, mudslides, wild fires or other natural disasters, weather conditions, *epidemics, pandemics* and other force majeure events in the United States or any other country or region in the world (except to the extent that such Effect has had a materially disproportionate adverse effect on the Company relative to other companies of similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect) (emphasis added);

(vii) any Effect resulting from the announcement of this Agreement or the pendency of the Merger, including the impact thereof on the relationships, contractual or otherwise, of the Company and its Subsidiaries with employees, suppliers, customers, partners, vendors, Governmental Authorities or any other third Person (other than for purposes of any representation and warranty contained in Section 3.5);

(viii) the compliance (other than compliance with the covenant to operate in the ordinary course of business pursuant to Section 5.1) by any Party with the terms of this Agreement, including any action taken or refrained from being taken pursuant to or in accordance with this Agreement;

(ix) any action taken or refrained from being taken, in each case to which Parent has expressly approved, consented to or requested in writing (including via email) following the date of this Agreement;
(x) changes or proposed changes in GAAP or other accounting standards or applicable Law (or the enforcement or interpretation of any of the foregoing) or changes in the regulatory accounting requirements applicable to any industry in which the Company and its Subsidiaries operate (except to the extent that such Effect has had a materially disproportionate adverse effect on the Company relative to other companies of a similar size operating in the industries in which the Company and its Subsidiaries conduct business, in which case only the incremental disproportionate adverse impact may be taken into account in determining whether there has occurred a Company Material Adverse Effect);

(xi) changes in the price or trading volume of the Company Common Stock, in each case in and of itself (it being understood that any cause of such change may be deemed to constitute, in and of itself, a Company Material Adverse Effect and may be taken into consideration when determining whether a Company Material Adverse Effect has occurred);

(xii) any failure, in and of itself, by the Company and its Subsidiaries to meet (A) any public estimates or expectations of the Company's revenue, earnings or other financial performance or results of operations for any period; or (B) any internal budgets, plans, projections or forecasts of its revenues, earnings or other financial performance or results of operations (it being understood that any cause of any such failure may be deemed to constitute, in and of itself, a Company Material Adverse Effect and may be taken into consideration when determining whether a Company Material Adverse Effect has occurred);

(xiii) the availability or cost of equity, debt or other financing to Parent or Merger Sub;

(xiv) any Transaction Litigation or other Legal Proceeding threatened, made or brought by any of the current or former Company Stockholders (on their own behalf or on behalf of the Company) against the Company, any of its executive officers or other employees or any member of the Company Board arising out of the Merger or any other transaction contemplated by this Agreement; and

(xv) any matters expressly disclosed in the Company Disclosure Letter.