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RETHINKING THE U.S. APPROACH TO MATERIAL ADVERSE CHANGE CLAUSES IN MERGER AGREEMENTS

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I. THE ROLE OF MATERIAL ADVERSE CHANGE CLAUSES IN MERGER AGREEMENTS

When entering into a contract of any kind, parties strategically structure their negotiations to maximize potential gains and minimize potential losses. In discerning the probability of the potential upside or downside of a transaction, parties to large commercial transactions typically focus on the magnitude of risk that a deal requires them to take.[1] Consequentially, modern contract provisions have evolved to enable parties to allocate the various types of risk associated with a given transaction, with the ultimate goal of producing a contract amenable to the needs and concerns of both parties. In the context of modern merger and acquisition agreements, an array of risk-allocating provisions have become common-place, drafted with the goal of providing parties with a

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[1] STANLEY FOSTER REED, ALEXANDRA REED LAJOUX & H. PETER NESVOLD, THE ART OF M&A: A MERGER/ACQUISITION/BUYOUT GUIDE 465 (4th ed. 2007) (explaining that negotiations of merger agreements is "in large part, an effort by the parties to allocate the risk . . . .").

certain degree of flexibility between the time that a definitive merger agreement is executed and the closing of the transaction.

While contracts to acquire any sort of asset typically incorporate a negotiated "due diligence period" between the date on which the parties enter into the contract (the execution date) and the date on which the purchase price is paid and title to the asset is transferred to the purchaser (the closing date), merger agreements in the U.S. are unique as certain corporate and regulatory requirements *necessitate* such a gap in time to remain in compliance with applicable law.[2] Thus, many of the risk-shifting devices in merger agreements relate to the potential that the asset being acquired (the target company) might deteriorate during that gap period.[3]

For example, representations and warranties regarding specific legal and/or financial conditions or events—such as the risks associated with third-party litigation being brought against the target—shift the risk associated with any number of factors to the appropriate party, potentially allowing a party to walk away from a deal should a certain risk be realized. Similarly, termination fees insure potential acquirors against the risk that the target will pull out of a merger (which is likely to occur upon receipt of a superior bid) by compensating them for the expense of their negotiation efforts should a deal fall apart. Conversely, earn-out provisions provide a mechanism to affect pre-negotiated purchase price adjustments, thus reducing the target's risk that it might miss out on an unanticipated windfall resulting from the synergies generated by the merger's consummation. Today, such provisions are standard fare in merger agreements,[4] and so-called "hell or high water deals"—which provide no walk-away rights to the parties under any circumstances—are a rarity.[5]

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

[3] *Id.*

[4] *See generally* Theodore N. Mirvis, *Takeover Law and Practice 2010*, 1808 PRACTISING LAW. INST./CORP. 529, 601 (2010) (discussing the Delaware Supreme Court's acquiescence to "deal protection" devices).

[5] Eric L. Talley, *On Uncertainty, Ambiguity, and Contractual Conditions*, 34 DEL. J. CORP. L. 755, 758 (2009).

Another class of contract provision is known as a "material adverse change" ("MAC") or "material adverse effect" ("MAE") clause; both of these are generally referred to as a MAC clause. These clauses are intended to trigger a party's right to walk away from a transaction when an adverse change not otherwise specifically accounted for in the contract occurs, subsequent to the execution date but prior to closing, that has a significant negative impact on either party to the transaction or on the potential success of the merger itself.[6] MAC clauses appear in some form in virtually all public-company merger agreements.[7] Unlike with other risk-shifting devices (such as terminations fees), which typically call for liquidated damages, when one party suffers a MAC, as defined in the contract, the other party has the right to walk-away from that transaction without incurring any associated cost.[8]

As discussed further in Part I, MAC clauses are thought to serve as a backstop to the contract's risk-allocation devices, guarding against the risks associated with unforeseen or unforeseeable events that cannot practicably be drafted into a contract with specificity. However, the lack of clarity provided by the Delaware Court of Chancery as to what sort of unforeseen or unforeseeable events rise to the level of "materiality" has led to a market in which MAC clauses now give "rise to more disputes and more litigation than any other provision of business combination agreements."[9]

Part II will explore positive and negative consequences of vague contract language, and why parties appear to insist on vague MAC clauses in merger agreements. Part III will provide an overview of United States case law concerning MAC clauses. Part IV will discuss the resulting Delaware case law, which has significantly called into question the practical utility of MAC clauses as a mechanism for allowing an acquiror to terminate a merger transaction, and created a great deal of uncertainty in the market for

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[6] Mirvis, *supra* note 4, at 611.

[7] *Id.*

[8] Miller, *supra* note 2, at 2012.

[9] Robert Miller, *Canceling the Deal: Two Models of Material Adverse Change Clauses in Business Combination Agreements*, 31 CARDOZO L. REV. 99, 105 (2009) (discussing the failure of MAC clauses that inadequately define a materiality standard).

mergers and acquisitions. Part V will analyze the current (and arguably negative) practical consequences of that case law, looking at the impact that a MAC has on targets, as well as the leverage the clauses can provide to acquirors.

Against this backdrop, this Article will argue that the existing approach to drafting MAC clauses has proven unworkable in practice, and thus, that a fundamental reevaluation of how MAC clauses are drafted in merger agreements is warranted. In evaluating what considerations should be taken into account in devising such a reevaluation of the domestic approach to MAC clauses, Part VI will look to the British approach to interpreting and drafting MAC clauses in order to assess whether that alternative regime offers any useful lessons for parties to U.S. merger agreements. Finally, Part VII will evaluate potential solutions to mitigating the uncertainty associated with MAC clauses.

II. INTRODUCTION TO MATERIAL ADVERSE CHANGE CLAUSES

A. Evolution of the Modern MAC Clause

It is only in recent history that MAC clauses have become a focal point of negotiation, litigation and legal discourse.[10] Until recently, MAC clauses had been considered mere "boilerplate" provisions,[11] which were typically drafted broadly and demanded little attention from drafting attorneys.[12] As traditionally drafted, a MAC clause would typically provide that "any change, occurrence or state of facts that is materially adverse to the business, financial condition or results of operations" of the target after execution of the contract would permit the buyer to terminate the transaction.[13]

MAC clauses first began to garner attention following the economic volatility of the later 1980s, and more so in the 1990s amidst

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

[11] Andrew C. Elken, Note, *Rethinking the Material Adverse Change Clause in Merger And Acquisition Agreements: Should The United States Consider The British Model*, 82 S. CAL. L. REV. 291, 292 (2009).

[12] Brooks, *supra* note 10, at 85.

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

increased turmoil in the capital and product markets.[14] While the economic climate of the late 1980s and 1990s began to yield increased attention to MAC clauses from attorneys, generating a more complex structure of the provisions themselves, it was not until the turn of the 21st century that MAC clauses, and the uncertainty surrounding the added protection that they are intended to provide, became the controversial source of debate that they are today.[15]

Academics have pointed to three major developments as the primary stimuli for the increased attention to MAC clauses at the turn of the century.[16] First, the decline in the stock market in early 2001 led to an increase in acquirors looking for potential ways to walk away from purchasing soured assets.[17] Also in 2001, the Delaware Court of Chancery released its opinion in *IBP, Inc. v. Tyson Foods, Inc.*[18]—a decision (more specifically explored in Part IIIa) that substantially called into question the ultimate utility of MAC clauses in practice as a mechanism for terminating a transaction.[19] Lastly, and least surprisingly, the attacks of September 11, 2001 brought terrorism into the forefront of the public eye, giving cause for practitioners to consider new extreme circumstances under which MAC clauses might come into play.[20] It was following these developments that MAC clauses began to evolve into the complex risk-allocation devices that appear in merger agreements today, commonly carving-out certain events deemed to be beyond the control of the target from the definition of MAC.[21]

Further attention was again drawn to MAC clauses in the wake of the Delaware court's famous decision in *Omnicare, Inc. v. NCS Healthcare, Inc.*[22] There, the court held that targets are required to

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[14] Brooks, *supra* note 10, at 85.
[15] *Id.* at 85-86.
[16] *Id.* at 86.
[17] *Id.*
[18] IBP, Inc. v. Tyson Foods, Inc., 789 A.2d 14 (Del. Ch. 2001).
[19] *See* Brooks, *supra* note 10, at 86.
[20] *Id.*
[21] Elken, *supra* note 11, at 293.
[22] Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003) (requiring an effective fiduciary out clause to protect from preclusive and coercive defensive devices); Brian JM Quinn, *Optionality in Merger Agreements*, 35 DEL. J. CORP. L. 789, 790 (2010).

negotiate an effective "fiduciary out" into merger agreements, allowing the target to walk away from a deal should its directors' fiduciary duties require them to do so upon being presented with a superior bid from another buyer.[23] The *Omnicare* decision and the increased flexibility it offered to targets subsequently spawned further attention to whether and how acquirors might be in a position to negotiate symmetrical flexibility on their end of transactions through MAC clauses and other deal protection devices.[24] The heightened focus of acquirors and legal practitioners on MAC clauses drew increased attention of legal and economic theorists struggling to identify the scope and utility of MAC clauses in merger agreements.[25]

MAC clauses once again began to dominate headlines in the United States following the credit crisis and economic downturn commencing in 2007 and through the height of the credit bubble in 2008, during which time several high profile acquisition transactions collapsed, some of which resulted in controversial litigation in Delaware courts.[26] During that period, as many as thirteen high-profile MAC disputes arose—the four largest of which ranged from $1.5 billion to $25.3 billion.[27] Those disputes were largely responsible for exposing to both courts and theorists the relatively new MAC drafting practices that had by that time become standard in merger

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[23] *See Omnicare*, 818 A.2d at 938.

[24] *See* Quinn, *supra* note 22, at 790-91.

[25] *See id.* at 792.

[26] *See* Elken, *supra* note 11, at 291-92.

[27] *Id.* at 292 & n.3 ("Finish Line unsuccessfully alleged a MAC in Tennessee Chancery Court after refusing to close a $1.5 billion acquisition of Genesco; the private equity consortium of Bain Capital, the Carlyle Group, and Dubilier & Rice threatened Home Depot with a MAC claim after an agreement to purchase HD Supply for $10.325 billion, which resulted in a renegotiated agreement for nearly $2 billion less; Sallie Mae filed suit against the consortium of J.C. Flowers, JP Morgan Chase, and Bank of America, claiming that the consortium wrongfully asserted that a MAC occurred in refusing to close a $25.3 billion merger; KKR and GS Capital Partners asserted a MAC claim in refusing to close an $8 billion acquisition of Harman International." (citing Wachtell, Lipton, Rose & Katz, *Recent MAE Situations, Address at the National Economic Research Associates Symposium: When can Buyers Walk? The Material Adverse Change Clause* (Dec. 6, 2007) (presentation on file with author))).

agreements.[28] Today, MAC clauses are recognized as having "given rise to more disputes and more litigation than any other provision of business combination agreements."[29]

B. *Structure of Modern MAC Clauses*

As noted above, the structure of modern MAC clauses in merger agreements has evolved significantly from their origins as simple boilerplate provisions. How and whether a MAC clause might be invoked by either party to a merger agreement hinges primarily on how the parties define the term "material adverse change."[30] That definition is then typically incorporated into merger agreements in two ways.[31] First, in its broadest application, the absence of a MAC impacting the target's business condition commonly appears as a stand-alone clause among the conditions precedent to closing the transaction.[32] This application is commonly referred to as the acquiror's "MAC out."[33] Second, the defined term, MAC, is typically

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[28] *See* Elken, *supra* note 11, at 293.

[29] Daniel Gottschalk, Comment, *Weaseling Out of the Deal: Why Buyers Should Be Able to Invoke Material Adverse Change Clauses in the Wake of a Credit Crunch*, 47 HOUS. L. REV. 1051, 1058 (2010) (quoting Miller, *supra* note 9, at 122).

[30] Dennis J. Block, *Securities Law Aspects of Mergers, Acquisitions and Other Corporate Transactions*, *in* 2 UNDERSTANDING THE SECURITIES LAWS 2010, at 355, 398 (Practising Law Inst. 2010).

[31] *Id.* at 399.

[32] *See 2010 Nixon Peabody MAC Survey: A Nixon Peabody Study of Current Negotiation Trends of Material Adverse Change Clauses in M&A Transactions*, NIXON PEABODY LLP, 1, http://nixonpeabody.com/linked_media/publications/MAC_Survey_2010.pdf (last visited Oct. 6, 2011) [hereinafter *Nixon Peabody MAC Survey*]. Nixon Peabody initiated this annual survey following the dramatic stock market decline in 2000 and the events of September 11, 2001 to track their effects on the negotiation of MAC provisions in merger and acquisition agreements. The 2010 study examines 345 asset purchase, stock purchase, and merger transactions with values of $100 million or greater executed between June 1, 2009, and May 31, 2010. The surveyed transactions represent a variety of important industries and range in value from $100 million to $55.3 billion. The survey notes that while this study is "not technically scientific and does not include private transactions for which no agreement was made available, [they] believe the results are statistically representative of the climate of M&A transactions during the period." *Id.* It should be noted that, in some respects, this survey functions as a marketing tool for Nixon Peabody.

[33] *Id.*

utilized as a qualifier to "bring-down" various representations and warranties to the time of closing.[34] This is done in order to ensure that the acquiror is ultimately purchasing the same entity—both from a legal and a financial perspective—it bargained for when it executed the merger agreement.[35]

Today, the base definition of a "material adverse effect" in a standard merger agreement might read as follows:

> [A]ny change, event, or effect that, either individually or in combination with all other changes, events, or effects: (1) has a material adverse effect on the business, operations, assets, liabilities (including contingent liabilities), financial condition, or results of operations of such entity and its subsidiaries taken as a whole, or (2) could reasonably be expected to materially impair the ability of such entity to consummate the merger and to perform its other obligations under the merger agreement.[36]

In the wake of each of the events of the 1990s and early 2000s discussed above, practitioners began to supplement the base definition of MAC by including both "carve-ins" (inclusions) and "carve-outs" (exclusions).[37] In negotiating the base definition of MAC along with the carve-ins and carve-outs that follow, targets attempt to limit the scope of the definition of MAC in order to decrease the potential for a court to find a change or combination of changes sufficient to constitute a MAC under an agreement.[38] Conversely, acquirors push for as broad a definition of MAC as possible both to increase the chances that a court will find a change or combination of changes to constitute a MAC, as well as to increase the acquiror's leverage over the target in the event that the acquiror desires to terminate or renegotiate the terms of the transaction.[39] For that reason

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[34] Block, *supra* note 30, at 398.
[35] REED ET AL., *supra* note 1, at 469.
[36] Block, *supra* note 30, at 399.
[37] Brooks, *supra* note 10, at 86.
[38] *Id.* at 86-87.
[39] *See id.* at 87.

(as discussed further in Part Vb), a broadly drafted MAC clause has been said to function as a "bargaining chip" for the acquiror.[40]

The prevalence of MAC inclusions and exclusions in the public merger agreements in the U.S. has varied over the last decade,[41] most likely in response to the historical events described above. Between 2004 and 2007—following the events of September 11, the market crash of 2001, and the court decisions in *IBP* and *Omnicare*—merger agreements began to exhibit MAC clauses with less expansive inclusions and an ever-increasing list of exclusions.[42] Following the credit crunch in 2008 and 2009, a reversal of that trend became apparent, pointing toward an increase in the bargaining power of acquirors in a tumultuous credit market.[43] These shifts in the use of MAC inclusions and exclusions can also be tied to market trends in merger agreements, which on a whole have oscillated "from relatively buyer-friendly to seller-friendly and back to buyer-friendly", in tandem with the availability of credit to finance larger acquisitions.[44]

Several carve-outs have become standard practice in drafting MAC clauses.[45] Commentators have noted that the principal purpose of such carve-outs appears to be to remove systematic or industry risk from the definition of MAC, as well as certain risks already known to the parties at the time of contracting.[46] Such common exceptions include changes or effects caused primarily by conditions: (i) affecting the domestic or global economy as a whole; (ii) affecting the target's industry generally, unless such conditions have a disproportionate effect on the target as compared to the industry as a whole; (iii) primarily caused by or related to the announcement or pendency of the merger; (iv) stemming from shareholder class-action litigation arising from allegations of breach of fiduciary duty related

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[40] Gottschalk, *supra* note 29, at 1056 (quoting Jeffrey Thomas Cicarella, Note, *Wake of Death: How the Current MAC Standard Circumvents the Purpose of the MAC Clause*, 57 CASE W. RES. L. REV. 423, 426-27 (2007)).

[41] *See Nixon Peabody MAC Survey*, *supra* note 32, at 1.

[42] *Id.*

[43] *See id.*

[44] Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 869 (2010).

[45] *Id.* at 867.

[46] *Id.*

to the merger; (v) resulting from actions taken at the request of one of the parties contemplated by the merger agreement; (vi) related solely to a decline in the target's stock price;[47] (vii) resulting from changes in laws and regulations, or in interpretation of laws by courts or government entities;[48] and (viii) resulting from terrorism, acts of war, and changes in political conditions.[49]

It remains somewhat unclear why acquirors appear to be so willing to include some of the exceptions listed above. It can be speculated that the decision of acquirors to include certain exceptions may be linked to corresponding concessions by targets, such as purchase price adjustments. Another potential explanation may be that such exceptions are agreed to by acquirors in exchange for targets accepting a so-called "financing-out condition," which allow acquirors to walk away from a transaction should it be unable to obtain adequate financing on terms agreed to by the parties to the merger agreement. Still, such explanations seem insufficient when contemplating why an acquiror would be willing to agree to arguably counterintuitive exceptions, such as exceptions for changes "related solely to a decline in the target's stock price," for example.

Carve-ins, as compared to carve-outs, remain a relative rarity in U.S. merger agreements.[50] Perhaps the most obvious explanation for the lack of carve-ins is that, by their very nature, inclusions—typically in the form of specific benchmarks—increase the risk that a transaction will not be consummated should those benchmarks be realized. Furthermore, it has been noted that MAC clauses are often written ambiguously by design.[51] From the target's perspective, ambiguity in drafting MAC clauses is viewed as preferable because it is thought to provide increased certainty that a transaction will close. Acquirors, on the other hand, appear to prefer ambiguity in drafting MAC clauses because they foresee being able to utilize the clause as leverage to renegotiate a transaction upon the occurrence of an event

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[47] Block, *supra* note 30, at 400.
[48] *See Nixon Peabody MAC Survey*, *supra* note 32, at 2.
[49] *Id.* at 8.
[50] *Id.*
[51] Gottschalk, *supra* note 29, at 1053.

that may or may not constitute a MAC under the terms of the agreement.[52]

III. AMBIGUITY IN CONTRACTING

The failure of parties to include carve-ins delineating specific bench-marks that constitute a MAC—especially in the wake of the Delaware court's decision in *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*[53] – has left some practitioners "somewhat puzzled by the absence of any discernable trend in this area."[54] Practitioners at Nixon Peabody note that:

> Since *Hexion*, we have expected the traditional MAC out to be modified over time, either by adding more specific elements, such as a failure to meet specific financial milestones, decreases in sales levels beyond a certain threshold, or customer defections and other "quantifiable" terms that may unequivocally excuse performance, or by incorporating these specific tests into additional closing conditions.[55]

Similarly, a recent article by partners at Fried Frank in *The M&A Lawyer* predicted that vague MAC conditions would begin to "give way to greater precision and specificity[,]" and that parties would begin to "attempt to quantify a MAC by specifying changes in agreed-upon metrics[.]"[56] The failure of parties to embrace such drafting alternatives is arguably not the best course of action for either the parties themselves or for public policy. Indeed, the Delaware Chancery has discussed the value of more precise language.[57] Furthermore, in one of the few cases where a U.S. court

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[52] Brooks, *supra* note 10, at 86.
[53] Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715 (Del. Ch. 2008).
[54] *Nixon Peabody MAC Survey*, *supra* note 32, at 4.
[55] *Id.*
[56] Peter S. Golden, Arthur Fleischer Jr. & David N. Shine, *Negotiated Cash Acquisitions of Public Companies in Uncertain Times*, M&A LAW., Feb. 2009, at 6.
[57] *See* IBP, Inc. v. Tyson Foods, Inc., 789 A.2d 14, 65-66, 68 & n.155 (Del. Ch. 2001) (lamenting the "risk" of "uncontrollable factors" resulting from "capacious" MAC clauses).

actually found that a MAC had occurred, a specific dollar threshold was included in the contract.[58] Still, in practice, an overall lack of response to *Hexion* from attorneys drafting MAC clauses persists.[59]

A. Is Ambiguity in Contracting Always a Bad Thing?

Given the lack of a discernable trend toward increased specificity in MAC clauses, it should be evaluated whether ambiguity in contracting is actually viewed negatively from the perspective of the parties. In their article, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, Albert Choi and George Triantis evaluate both the upside and downside of intentionally incorporating ambiguity into merger agreements.[60] To begin, they discuss the more commonly understood downside of ambiguity: "[v]ague contract terms invite self-interested and conflicting interpretations[,]"[61] thus catalyzing disputes between the parties and "increas[ing] the resources expended in litigation and the uncertainty of judicial outcomes."[62] The resulting uncertain judicial decisions are criticized for creating "incentives for wasteful game-playing by each party[,]" as "[b]uyers are emboldened to threaten to walk from deals in circumstances in which the alternative precise provision would have foreclosed such an option."[63] Thus, vague contracts are "generally regarded as being antithetical to efficient business descision making."[64]

However, Choi and Triantis go on to explain that vagueness may be justified "when the expected larger litigation costs are outweighed by saving on the front end, in lower drafting costs."[65] Furthermore, Choi and Triantis argue that uncertainty in contracting actually "promotes deal making because each side can see what it

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[58] *See* Nip v. Checkpoint Sys. Inc., 154 S.W.3d 767, 769-70 (Tex. App. 2004) (finding that the loss of future income and business from a major customer was at least equal to the $50,000.00 threshold established in the contract for a MAC).
[59] *See* Choi &Triantis, *supra* note 44, at 881.
[60] *See* Choi & Triantis, *supra* note 44.
[61] *Id.* at 854.
[62] *Id.* at 882.
[63] *Id.*
[64] *Id.*
[65] *Id.* at 854.

wants to see in vague language[,]" thus limiting the potential that a negotiation might break down due to a difference in opinion between the parties.[66] The authors go on to discuss that vague language can limit "adverse signaling"; the potential for a party proposing greater precision in language "may send an adverse signal [to the other party] that it believes divergence of interests and litigation to be more likely."[67] Potential consequences of such adverse signals could be so grave as to include an adjustment in deal price or even a complete collapse of negotiations.[68] Finally, the authors argue that the increased litigation resulting from vague provisions may actually "improve contracting by operating as a screen on the seller's decision to sue[,]"[69] and in turn, augment the bargaining power of the buyer.[70] In other words, Choi and Triantis advance the notion that the high litigation costs created by vague language are actually a virtue, rather than a fault,[71] because such litigation costs can "work as an ex post signaling device that promotes efficient renegotiation."[72]

Despite the potential positives associated with vague contract language, as discussed more particularly below, the practical problems created by ambiguity in the context of MAC provisions still appears to outweigh the potential benefits.

IV. UNITED STATES CASE LAW INTERPRETING MAC CLAUSES

Importantly for would-be acquirors, the Delaware Court of Chancery has given strong reason to believe that the enforceability of MAC clauses may be extremely limited. In fact, the Court has never once found sufficient facts to excuse a party's merger agreement obligations under a MAC clause.[73] Specifically, the cases of *IBP, Inc. v.*

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[66] *Id.* at 884-85.
[67] *Id.* at 886.
[68] *See id.*
[69] *Id.* at 854.
[70] *See id.*at 887-88 (observing that a vague MAC clause can lead parties to settle at a lower price).
[71] *Id.* at 883.
[72] *Id.* at 891.
[73] *See* Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008) (acknowledging that Delaware courts have never found a material adverse effect in a merger agreement).

Tyson Foods, Inc.,[74] *Frontier Oil Corp. v. Holly Corp.*,[75] and *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*,[76] have significantly called into question the ultimate effectiveness of MAC provisions. It is now difficult to hypothesize a scenario in which Delaware courts would actually permit an acquiror to exercise its walk-away rights under a MAC provision. Commentators have noted that while the interpretation of the provisions has had a significant financial effect on the parties to such failed transactions, there has been an "even greater ex ante impact on the contract design of future deals."[77] Indeed, much of the enhanced flexibility theoretically offered by MAC clauses—which acquirors spend so much time, money, and effort negotiating for—may well be illusory in practice.

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

In *IBP, Inc. v. Tyson Foods, Inc.*, a landmark decision among those interpreting MAC clauses, the court rejected Tyson's claim that the occurrence of a MAC excused its obligations as acquiror under a $4.7 billion agreement[78] to acquire the beef and pork distributor, IBP.[79] The MAC clause in the merger agreement was broad and seemingly protective of Tyson, lacking the exclusions commonly negotiated by targets.[80] The clause provided Tyson with walk-away rights based on "any event, occurrence or development of a state of circumstances or facts which has had or reasonably could be expected to have a Material Adverse Effect . . . on the condition (financial or otherwise), business, assets, liabilities or results of operations of [IBP] and [its] Subsidiaries taken as a whole."[81] The drafters, thus, shifted the risk associated with a MAC primarily to the

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[74] IBP, Inc. v. Tyson Foods, Inc., 789 A.2d 14 (Del. Ch. 2001).
[75] Frontier Oil Corp. v. Holly Corp., No. Civ. A. 20502, 2005 WL 1039027 (Del. Ch. Apr. 29, 2005).
[76] *Hexion*, 965 A.2d 715.
[77] *See* Choi &Triantis, *supra* note 44, at 851.
[78] Brendan Murray, *Tyson has a deal to acquire IBP*, THE SEATTLE TIMES (Jan. 3, 2001, 12:00 A.M.), http://community.seattletimes.nwsource.com/archive/?date=20010103&slug=biztyson3.
[79] *IBP*, 789 A.2d at 23.
[80] *See id.* at 66.
[81] *Id.* at 65.

target, which was their goal. Nonetheless, Vice Chancellor Strine, looking to the terms of the contract as a whole, found it appropriate to construe the MAC clause from a "seller-friendly perspective."[82]

Tyson grounded its claim in part on projections (which the court adopted in its analysis) that the target's annual earnings would "deviate materially from the range in which [it] had performed [in recent years]",[83] and that as a result 2001 would be IBP's worst year since 1997.[84] While Strine acknowledged that he was "confessedly torn" on the MAC issue,[85] in light of the cyclical nature of the industry, he ultimately concluded that "[a]lthough IBP may not be performing as well as it and Tyson had hoped"[86] in the short term, that "IBP's earnings for the next two years would not be out of line with its historical performance during troughs in the beef cycle."[87] Strine's reasoning emphasized that a "Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror",[88] indicating that such effects must be "consequential to the company's earnings power over a commercially reasonable period . . . [which should be] measured in years rather than months."[89]

Due to Tyson's awareness of both the cyclical nature of the beef industry and of IBP's business specifically, the court reasoned that the potential for IBP's short-term earnings to fall 64% behind the comparable period in the previous year should have been somewhat familiar to Tyson, and thus, was not the sort of change in the target's condition that would qualify as a MAC.[90] The court noted that this sort of "hiccup"[91] in earnings could well be attributed, at least in part, to a severe winter leading ranchers to hold back livestock. Once winter concluded, the target could begin to perform more in line with

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[82] *Id.* at 68.
[83] *Id.* at 69.
[84] *Id.* at 69.
[85] *Id.* at 71.
[86] *Id.*
[87] *Id.*
[88] *Id.* at 68.
[89] *Id.* at 67.
[90] *Id.* at 69-71.
[91] *Id.* at 68.

Tyson's expectations.[92] Furthermore, the court pointed to the fact that Tyson's own investment banker maintained that the transaction still made "tremendous strategic sense."[93] Thus, *IBP* arguably counsels parties (particularly, acquirors) negotiating merger agreements to avoid reliance on broadly drafted MAC clauses to allocate the risk associated with short-term changes, either in the target's earnings or otherwise.[94]

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

Although the decision in *IBP* was reached under New York law,[95] it's analytical framework was adopted by the Delaware Court of Chancery four years later in *Frontier Oil Corp.* v. *Holly Corp.*[96] Unlike in *IBP*, the merger agreement in *Frontier Oil* was modified after its initial execution to specifically include a representation that no actions were pending or threatened against the target or its subsidiaries that would have a MAC—which was defined in the agreement—on the company.[97] Shortly thereafter, a wholly-owned subsidiary of the target was named in a series of toxic tort lawsuits that were initiated by environmental activist Erin Brockovich.[98] The impact of that litigation on the pending merger came to a head once it became clear that Frontier would not be able to rely on a "corporate separateness" defense given that it had guaranteed the obligations of its subsidiary under the lease agreement giving rise to the litigation.[99]

Although the court recognized that the pending litigation "could be catastrophic for Frontier[,]"[100] it ultimately reasoned that

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[92] *See id.* at 26.
[93] *Id.* at 50.
[94] Still, the temporal distinction is not entirely clear, as the court acknowledges in a footnote that a reported 50% decline in earnings over two consecutive quarters would likely constitute a material adverse development. *Id.* at 69 & n.156 (citing Raskin v. Birmingham Steel Corp., Civ. A. No. 11365, 1990 WL 193326, at *5 (Del. Ch. 1990)).
[95] *IBP*, 789 A.2d at 52.
[96] Frontier Oil Corp. v. Holly Corp., No. Civ. A. 20502, 2005 WL 1039027, at *34 (Del. Ch. April, 29, 2005).
[97] *Id.* at *4-5.
[98] *Id.* at *2, *11.
[99] *Id.* at *11.
[100] *Id.* at *36.

"the mere existence of a lawsuit cannot be determinative[,]" but rather, "[t]here must be some . . . basis in law and in fact for the serious adverse consequences prophesied by the party claiming the [MAC]."[101] Because Holly failed to make a sufficient showing that the litigation was substantially likely to prevail, and because the potential defense costs, while substantial, did not amount to a MAC in the context of the total value of the target's business, the court held that the acquiror failed to demonstrate that the litigation would result in a MAC.[102] However, the court left open the possibility that in at least some cases, "threatened litigation can be so certain, the outcome so predictable, and the likely consequences . . . so negative, that an observer could readily conclude that the impact that one would reasonably expect to result from the litigation would be material and adverse."[103] Reading the opinion as a whole, it remains unclear (perhaps even to the court itself) whether *Frontier Oil* should be read as setting a relatively low threshold (requiring only "some basis in law and in fact" for serious adverse consequences to arise) or a relatively high threshold (requiring conditions "so certain . . . so predictable . . . [and] so negative) for a MAC arising from threatened litigation.

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

Seven years after *IBP*, the Court of Chancery once again reached a holding indicative of the limited utility of MAC clauses in practice in *Hexion*.[104] *Hexion* involved a merger agreement between two large chemical companies with a purchase price of $10.6 billion,[105] representing a nearly 40% premium over the target's trading value[106]—an agreement the court recognized as being "more than usually favorable" to the target.[107] Shortly after execution of the

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[101] *Id.* at *41 n.224.
[102] *Id.* at *36-37.
[103] *Id.* at *35.
[104] Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008) (noting that "[a] buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close").
[105] *Id.* at 723.
[106] Talley, *supra* note 5, at 756.
[107] *Hexion*, 965 A.2d at 724.

merger agreement, Hexion's investment bankers reevaluated the merger against the backdrop of Huntsman's poor first quarter 2008 earnings, conflated by a worldwide credit crisis.[108] Based on evaluation, Hexion sought a declaratory judgment that that the merger, if consummated, would produce an insolvent company, and therefore, a material adverse change had occurred excusing its obligations under the contract.[109]

The base definition of "material adverse change" in the *Hexion* contract included "any occurrence, condition, change, event or effect that is materially adverse to the financial condition, business, or results of operations of [Huntsman] taken as a whole."[110] Unlike the provision in *IBP*, the MAC provision in *Hexion* was qualified by carve-outs excluding from the definition of "material adverse effect" (1) adverse changes to general economic or financial market conditions and (2) conditions affecting the chemical industry generally.[111] Each carve-out was then itself qualified to include in the definition of "material adverse change" conditions that disproportionately affect the target as compared to the market as a whole, or other chemical companies, respectively.[112]

Hexion further plead that in any case its maximum exposure, should it walk-away from the deal, was limited to the $325 million cancellation fee specified in the contract.[113] The court disagreed, finding that the new reports did not conclusively indicate that the merger would produce an insolvent company, that no material adverse event had occurred, and because Hexion's breach was "knowing and intentional"—a term provided under the contract—that its exposure was not capped by the liquidated damages provision.[114]

In *Hexion*, Vice Chancellor Lamb's opinion both echoed and elaborated upon much of the rationale espoused by the court in *IBP*. First, the court found that because both the debt and equity of the

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[108] *Id.* at 725.
[109] *See id.* at 730.
[110] *Id.* at 736.
[111] *Id.*
[112] *Id.* at 736-37.
[113] *I d.* at 746.
[114] *Id.*

target company were to be acquired in the merger, the operational results of the business was more relevant than the capital structure of the target.[115] Thus, "[b]ecause EBITDA is independent of capital structure," the court found it to be "a better measure of the operational results of a business."[116] After concluding that EBITDA, rather than earnings per share, constituted the appropriate benchmark to use in examining adverse changes, the court found that Huntsman's first-half 2008 EBITDA decrease of 19.9% from its first-half 2007 EBITDA was insufficient to constitute a material adverse change.[117] In so finding, the court again stressed the lasting perspective from which MAC clauses should be construed, favoring long-term rather than short-term evaluation.[118]

The court in *Hexion* also rejected the argument that Huntsman's second-half 2007 EBITDA deficiency of 22% below the projections it had originally presented to its bidders was sufficient to trigger Hexion's walk-away rights.[119] On that issue, the court pointed to the merger agreement's explicit disclaimer of any representation or warranty by Huntsman as to any of its projections, forecasts, or other estimates, construing the disclaimer as a signal that the parties "specifically allocated the risk to Hexion that Huntsman's performance would not live up to management's expectations. . . ."[120] However, it is not clear whether Hexion's claim would have been better received absent that disclaimer, as Lamb goes on to explain that the proper benchmark for determining whether a MAE has occurred is "to examine each year and quarter and compare it to the prior year's equivalent period"[121] and not, as Hexion plead, to examine whether a target has met its advertised projections.[122] Finally, the court also found that neither an increase of Huntsman's net debt by approximately 5% or 6%, nor problems related to specific divisions within Huntsman, rather than those relating to the

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[115] *Id.* At 740.
[116] *Id.*
[117] *Id.*
[118] *See id* .at 741.
[119] *Id.* at 740.
[120] *Id.* at 741.
[121] *Id.* at 742.
[122] *Id.* at 742.

company as a whole, were sufficient to constitute a material adverse change.[123]

There are three important lessons for acquirors stemming from the court's reasoning in *Hexion*. First, the court will not construe a MAC clause in a vacuum, outside the context of the entire contract.[124] Rather, even standard disclaimers such as the disclaimer in the *Hexion* agreement may be taken into account when assessing what sort of events the parties intended to constitute a MAC.[125] Second, as a general matter, a target's failure to meet projections will not be taken into account when determining whether a MAC has occurred, unless the contract indicates otherwise.[126] As Lamb suggests, rather than relying on a MAC provision, acquirers in Hexion's position are better served by negotiating for an earn-out provision, representations and warranties, or any number of alternatives, which might provide greater specificity in order to protect against a targets failure to meet projections.[127] Third, analysis of MAC provisions will look to the target as a whole, and not to its individual subsidiaries.[128] Lastly, if an acquiror is aware of factors concerning a target's capital structure and has based its assumptions on that knowledge, small changes to capital structure—such as a 5% or 6% increase in net debt—are insufficient to constitute a MAC.[129]

V. FLAWS IN THE DELAWARE COURT'S ANALYSIS OF MATERIAL ADVERSE CHANGE CLAUSES

A. Allocating the Burden of Proof

Strine's "seller-friendly" approach to interpreting MAC clauses, as established in *IBP*, has dominated MAC jurisprudence in the Delaware courts,[130] generating much criticism from legal theorists arguing that the one-sided approach is likely not appropriate in every

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[123] *Id.* at 744.
[124] *See id.* at 740-41.
[125] *Id.*
[126] *Id.* at 740-41.
[127] *See id.* at 741.
[128] *Id.* at 745.
[129] *Id.* at 744.
[130] Brooks, *supra* note 10, at 84.

single case interpreting a MAC clause.[131] Perhaps most-significantly, Strine's reasoning in *IBP* has been extended in subsequent cases, arguably incorrectly, for the proposition that the acquiror should always bear the heavy burden of proving the occurrence of a MAC.[132] Commentators have pointed to a potential flaw in logic behind that allocation of the burden of proof, arguing, among other points, that the target presumably has greater access to the information necessary to establish the occurrence or non-occurrence of a MAC in most, if not all, cases.[133]

The allocation of the burden of proof with respect to MAC clauses in merger agreements has also had a substantial impact on judicial determinations of MACs in other contexts. For example, in *Capital Justice LLC v. Wachovia Bank, N.A.*, where a borrower sought declaratory judgment that a lender was obligated to fulfill its obligations under a loan agreement upon the lender's calling of a MAC, the court rejected Wachovia's attempt to distinguish the case from *Hexion*.[134] There, the district court noted that in *Hexion*, the Delaware Chancery made clear that "absent clear language to the contrary, the burden of proof with respect to material adverse effect rests on the party seeking to excuse its performance under the contract."[135] Thus, notwithstanding the established notion that "a plaintiff in a declaratory judgment action should always have the burden of going forward[,]" the district court ultimately rejected Wachovia's argument that the burden should fall on the borrower.[136] In reaching its holding, the court reasoned that the *Hexion* decision "did not place the burden on the plaintiff because it was a declaratory judgment action", but rather, "the court placed the burden on the party asserting the existence of a MAC because MAC clauses are '*sui generis* among their contract clause brethren.'"[137] Furthermore, the

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[131] *Id.*

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

[133] Brooks, *supra* note 10, at 105.

[134] Capital Justice LLC v. Wachovia Bank, N.A., 706 F. Supp. 2d 23, 28 (D.D.C. 2009).

[135] *Id.* (citing Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 739 (Del. Ch. 2008)).

[136] *Capital Justice*, 706 F. Supp. 2d at 29 (citing *Hexion*, 965 A.2d 715 at 739).

[137] *Capital Justice*, 706 F. Supp. 2d at 29.

court made clear that, "[b]ecause MAC clauses are *sui generis*, the burden of proof is not determined by the form in which the MAC clause is drafted."[138]

B. *Uncertainty as to the Definition of "Materiality"*

Perhaps the most elusive factor in interpreting MAC clauses is generated by the apparent reluctance of parties to merger agreements to specifically define the parameters of the word "material." Absent such specific language defining "materiality," courts have been loath to establish a single benchmark that would trigger a MAC, instead favoring a fact-specific, case-by-case analysis.[139] What is clear, however, is that the MAC threshold is a steep one.[140]

In one veiled attempt to define "materiality," Paul Gadd, a partner at Ashurst Morris Crisp, commented that "material change is like an elephant - it is obvious when you see it."[141] However, it is rather clear that defining "materiality" is nowhere near as simple as Gadd makes it out to be, even for experienced practitioners. To illustrate, at the Clifford Chance law firm, a conference of bankers was asked to vote on whether any of the following might constitute a MAC: "a 10% drop in the EBIDTA ratio . . . a 25% drop in EBIDTA; an explosion in a high profit-margin factory of a corporate [sic] which produces a product representing 20% of turnover; and a change in regulation which would have a significant negative financial impact on the company."[142] While there was general agreement that it was

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[138] *Id.*

[139] *See* Weil, Gotshal & Manges LLP, *MAC/MAE Provisions: Rolling Credit Markets Render Navigating The Material Adverse Effect/Material Adverse Change Minefield Even More Challenging*, WEIL.COM, (Nov. 2007), http://www.weil.com/news/ pubdetail.aspx?pub=8009.

[140] *Id.*

[141] Jamie Ivey, *Takeover Ruling Fuels Adverse Change Debate*, CORP. FIN., Nov. 2001, at 1, *available at* ProQuest, Doc. ID 210165676. *See generally Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Ivey's characterization of materiality is reminiscent of Justice Potter Stewart's famous explanation of how to identify "hard-core" pornography: "I shall not today attempt further to define the kinds of material I understand to be embraced . . . [b]ut I know it when I see it").

[142] Ivey, *supra* note 141.

unlikely that the first event would constitute a MAC, the practitioners were split evenly as to the remaining three scenarios.[143]

As one commentator explains, the *IBP* decision can essentially be read as creating a four-part test for establishing that a change, event or occurrence is material under MAC clauses.[144] Under *IBP,* in order for an event, occurrence, or development to constitute a MAC:

> it must (1) "substantially threaten" (2) "the overall earnings potential" of the acquired company; (3) "in a durationally-significant manner" (measured in years, not months); and (4) be prove[n] to have been a change, not an event known when the acquisition agreement was signed.[145]

In practice, this test, along with the elaborations thereof set forth in subsequent MAC cases, ultimately lacks the clarity necessary to provide contracting parties with any sort of practical guidelines in drafting and negotiating MAC clauses. After all, "substantial" is nothing more than a synonym for "material," and the phrases "overall earnings potential" and "durationally-significant" are simply too subjective to be of any practical value in the way of understanding the threshold for materiality.

C. *Evaluating "Materiality" in Other Contexts*

Although the case law that has developed for syndicated lending is less robust than that which has developed in the context of merger agreements, the difficulty inherent in defining "materiality" has similarly come into play with respect to MAC clauses.[146] MAC clauses have traditionally been used in some form in loan

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[143] *Id.*

[144] Gottschalk, *supra* note 29, at 1062.

[145] *Id.* at 1062 (citing IBP, Inc. v. Tyson Foods, Inc., 789 A.2d 14, 68 (Del. Ch. 2001) (It should be noted that "[t]he requirement of durational significance may not apply when the buyer is a financial investor with an eye to short-term gain" (Choi & Triantis, *supra* note 44, at 877))).

[146] Douglas S. Buck & Erick S. Harris, *CMBS Lenders Begin Invoking MAC Clauses with Investors*, REAL EST. FIN., Apr. 2008, at 13, 13-15 (April 2008).

commitments, conditioning a lender's commitment to fund a loan on "the absence of any material adverse change, as determined by the lender, in the tenants, property, borrower or key principals."[147] Similarly, rate lock agreements often contain MAC clauses conditioning the agreement on "the absence of a material adverse change in the financial, real estate, banking or capital markets, including the mortgage-backed securities markets . . ."[148]

Courts evaluating MAC clauses in the context of commercial lending have been loath to establish a standard test to determine when a MAC has occurred.[149] Furthermore, courts have been quick to deem MAC clauses in the context of syndicated lending as being ambiguous as drafted.[150] For example, in *Capitol Justice LLC v. Wachovia Bank*, a MAC clause provided the lender with walk-away rights upon the occurrence of a "material adverse change in the capital, banking and financial market conditions that could impair the sale of the loan by [the l]ender as contemplated in the term sheet."[151] There, the court found that the MAC clause—although not atypical—was subject to multiple interpretations, reasoning that the clause could be interpreted as defining a MAC as either a "significant adverse change" or as "an unforeseeable adverse change."[152]

Similarly to the phenomenon discussed in Part Vb, the volatility of the CMBS markets in late 2008 enabled lenders to begin using vague MAC clauses as a means of backing out of, or renegotiating, their loans to investors.[153] This trend has prompted some commentators to suggest that investors strive to limit the application of MAC clauses by including specific financial thresholds as well as by conditioning MAC clauses with requirements of good faith and reasonableness.[154]

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[147] *Id.* at 14.
[148] *Id.*
[149] *Id.*
[150] *See* Capitol Justice LLC v. Wachovia Bank, N.A., 706 F. Supp. 2d 23, 29 (D.D.C. 2009).
[151] *Id.*
[152] *Id.* at 30.
[153] Buck & Harris, *supra* note 146, at 13, 14.
[154] *Id.* at 14.

VI. PRACTICAL CONSEQUENCES OF DELAWARE CASE LAW ON UNITED STATES MERGERS

The lack of clarity embodying the Delaware court's approach and the fact-specific analysis of "materiality" that dominates its MAC jurisprudence has produced significant and arguably negative consequences in the domestic market for mergers and acquisitions. Although the Delaware approach establishes an extremely seller-friendly approach to interpreting MAC clauses, that approach has also resulted in certain market conditions beneficial to buyers. While such consequences were likely unintended by the Delaware court, in some circumstances their market impact may nonetheless be so severe that public policy considerations demand a fundamental reevaluation of how MAC clauses are drafted and analyzed going forward.

A. Negative Impact on the Target Resulting From An Acquiror Calling a MAC

While the paradigm for interpreting MAC clauses established by the Court of Chancery calls into question whether a Delaware court would ever find an acquiror's claim sufficient to invoke its rights under a MAC clause, they nonetheless have serious practical implication from the perspective of targets. First, commentators and courts alike have recognized that once an acquiror asserts a claim that a MAC has occurred, regardless of ultimate judicial determination of the merits of the claim, the effect of the claim alone nonetheless has a substantial detrimental effect on the target. As the Delaware Court of Chancery explained in *In re Dollar Thrifty Shareholder Litigation*, "[i]n the wake of such failed deals, the formerly desired targets have often suffered, both in terms of operating performance and market valuation."[155] "Simply put, when a merger between public companies blows up because one company has declared a MAC on the other, it is big news in the business world."[156] As one commentator notes, "it is much worse for a party to be declared MAC'd by its counterparty on the basis of a materializing risk than just to suffer the materialization of that risk" because of the negative public exposure

[155] *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 616 (Del. Ch. 2010).
[156] Miller, *supra* note 2, at 2077-78.

of the target's business resulting from such a declaration.[157] In addition, the Delaware Court of Chancery has recognized that a MAC clause can generate "contractual rights of inhibition" for parties to a merger agreement, thus having the practical effect of enabling the acquiror to "t[ie] up" the operations of the target, which is also likely to be an industry competitor.[158]

B. Using a MAC as Leverage to Renegotiate a Transaction

Despite the overwhelmingly "seller-friendly" approach adopted by the Delaware Chancery, the lack of clarity in the standards underlying their approach may ultimately put acquirors at an advantage in practice. In recent years, a trend has developed whereby an acquiror who suspects that a MAC has occurred can leverage the threat of termination in order to renegotiate favorable contract terms whether or not they might actually have a viable claim under a MAC clause.[159]

(i) Bank of America, Merrill Lynch, and the United States Government

Perhaps the most high profile example of how a MAC clause can generate significant leverage for an acquiror stems from the recent $50 billion acquisition by Bank of America of the floundering investment bank, Merrill Lynch[160]—a deal that was recognized by then-Treasury Secretary Henry Paulson as vital to "the stability of the

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[157] *Id.* at 2009 (explaining that the declaration of a MAC can result in "a public dispute about whether the company has been MAC'd ... imperils its relations with employees, customers, creditors, and others with whom it does business; publicly releases negative information about the company that otherwise would have remained confidential; exposes the company to disparagement by the counterparty; and, if the dispute is litigated, can even lead to a public certification by a court that that the company is, in effect, damaged goods").

[158] Transcript of Scheduling Conference at 29, SLM Corp. v. J.C. Flowers II L.P., C.A. No. 3279-VCS (Del. Ch. Oct. 22, 2007), *dismissed*, Jan. 28, 2008.

[159] *See* Weil, Gotshal & Manges LLP, *supra* note 139.

[160] *See Bank of America to Purchase Merrill Lynch: Deal Worth $50 Billion Creates Financial Giant that Rivals Citigroup*, MSNBC (Sept. 15, 2008, 12:45 AM), http://www.msnbc.msn.com/id/26708958.

entire U.S. economy."[161] After entering into the merger agreement in September of 2008,[162] Merrill's losses began to skyrocket in October and November of 2009 beyond the expectations of the parties.[163] Rather than utilizing the potential MAC claim as a means of renegotiating the terms of the merger agreement with Merrill, Bank of America used the combined force of its leverage under the MAC clause and the importance of the transaction to the U.S. economy in order to essentially "muscle the federal government and U.S. taxpayers into ponying up more bailout funds."[164]

Although the federal government's lawyers—likely taking into account the impact of recent MAC case law—did not believe that a MAC claim would be successful if exercised, the threat that the publicity of such a claim "'would likely cause the demise of Merrill Lynch'" and significantly damage the nation's then fragile economy, provided Bank of America with significant leverage against the government.[165] As a result of that leverage, Bank of America was ultimately able to convince Federal Reserve Chairman, Ben Bernanke, to invest another $20 billion in bailout funds and provide further protection against losses on nearly $118 billion in toxic assets.[166]

Of course, the Bank of America/Merrill Lynch transaction arose under unique circumstances that are perhaps unlikely to be reproduced in more typical merger transactions in which the state of the entire U.S. economy is not at stake. However, the basic paradigm of an acquiror using a MAC claim to generate leverage in merger transactions still appears to be a strategy that has been latched on to by acquirors in more typical transactions.

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[161] *See* Sue Reisinger, *How Bank of America Used Merrill Losses to Bully the Government: When Bank of America Considered Nuclear Option*, LAW.COM (Sept. 29, 2009), http://www.law.com/jsp/article.jsp?id=1202434147719&slreturn= 1&hbx login=1, *also available at* http://www.lexisnexis.com.

[162] *See Bank of America to Purchase Merrill Lynch: Deal Worth $50 Billion Creates Financial Giant that Rivals Citigroup*, *supra* note 160.

[163] *See* Reisinger, *supra* note 161, at 1.

[164] *Id.* at 2.

[165] *Id.* at 3.

[166] *Id.*

(ii) Sallie Mae and J.C. Flowers & Co.

A similar stand-off occurred in connection with the failed acquisition of Sallie Mae by a consortium of investors led by J.C. Flowers & Co.[167] The merger agreement executed by the parties in April 2007 provided that a MAC included a material adverse effect on the target, excluding those effects resulting from changes in applicable law, but including (a) effects arising from those changes in applicable law relating to the education-finance industry, and (b) effects that are in the aggregate more adverse to the target than the legislative proposals described in the target's most recent Form 10-K.[168]

In September 2007, when federal legislation was passed cutting subsidies to student lenders, the buyers attempted to terminate the deal under the MAC provision, arguing that the impact of the legislation was greater than what had been described in Sallie Mae's Form 10-K.[169] As a result, Sallie Mae sued the buyers in the Delaware Court of Chancery in an attempt to either force the closing of the transaction or, in the alternative, pay the $900 million termination fee provided for in the agreement.[170] Ultimately, the buyers were able to use the uncertainty as to whether the events were sufficient to constitute a MAC as leverage to convince Sallie Mae to terminate the agreement and to drop their claim for the termination fee in exchange for a $31 billion refinancing of Sallie Mae Debt.[171]

(iii) Home Depot, Inc. and Pro Acquisition Corp.

Another example of how an acquiror can utilize a vague MAC claim to force a target to renegotiate the terms of a transaction arose in the failed acquisition of HD Supply, Inc. and CND Holdings, Inc., subsidiaries of Home Depot, Inc., by Pro Acquisition Corporation.[172] After the parties entered into a merger agreement in June 2007, under which the acquirors agreed to purchase all of the

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[167] Block, *supra* note 30, at 401.
[168] *Id.*
[169] *Id.* at 402.
[170] *Id.*
[171] *Id.*
[172] *Id.* at 401.

capital stock of the target corporations for $10.325 billion, Pro Acquisition asserted that the collapse of the housing market and the ensuing general turmoil in the credit market constituted a MAC under the agreement.[173] This claim was particularly questionable, given that both changes conceivably fell within the agreement's carve-outs to the definition of MAC. Nonetheless, the purchaser was able to use this dubious claim as leverage compelling the target to lower the purchase price under the merger agreement to $8.5 billion—representing a 17.6% discount of the original purchase price.[174]

C. *Other Potential Consequences*

In addition to the existing trends described above, the current Delaware approach to MAC clauses has the potential to generate systemic change in the market for mergers and acquisitions. First, the decreased flexibility permitted to acquirors through MAC clauses as a result of the "seller-friendly" approach may drive up—and may already be driving up—the purchase price in some merger transactions. Second, it is possible acquirors will begin to push to have their merger agreements governed by the laws that are more friendly to acquirors in MAC disputes.[175]

VII. REVIEW OF BRITISH APPROACHES TO MAC CLAUSES

In the United Kingdom, Public merger agreements are regulated by the Panel on Takeovers and Mergers ("Takeover Panel").[176] The Takeover Panel is an independent body established in 1968 consisting of up to thirty-four members drawn from selected business and financial organizations.[177] Its primary function is to issue and administer the City Code on Takeovers and Mergers ("City Code"), which provides a framework for takeovers in the U.K. and is

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[173] *Id.*
[174] *Id.*
[175] For example, the case law that has developed in Tennessee may be a more friendly option for acquirors. *See, e.g.*, Genesco, Inc. v. The Finish Line, Inc., No. 07-2137-II(III), 2007 WL 4698244 (Tenn. Ch. Dec. 27, 2007).
[176] Elken, *supra* note 11, at 319-20.
[177] *Id.* at 320.

designed to promote the integrity of the financial markets.[178] While MAC clauses appear less frequently in the U.K. than in the U.S., a substantial body of law has nonetheless developed to govern their operation in U.K. merger agreements.[179]

A. The U.K. Takeover Panel and City Code

The City Code is based on six guiding principles that takeovers must follow.[180] Each such principle expressly overrides the more specific language of the thirty-seven City Code Rules.[181] The fourth such principle, which has been recognized as the most pertinent in the context of interpreting MAC clauses,[182] provides:

> False markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.[183]

The fourth general principle expresses the concern of the Takeover Panel that ambiguity surrounding acquirors' ability to terminate merger transactions has a negative impact on the securities market as a whole, and thus, there is a preference for clarity in contracts effecting the market for securities.[184]

In addition, the City Code sets forth certain regulations relating specifically to MAC clauses.[185] First, Rule 13.1 disallows MAC clauses that depend solely on subjective judgments of either

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[178] *See* THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE A3-A7 (RR Donnelley, 10th ed. 2011) [hereinafter City Code], *available at* http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf.
[179] Elken, *supra* note 11, at 319-20.
[180] *Id.* at 320.
[181] City Code, *supra* note 178, at A2, B1.
[182] Elken, *supra* note 11, at 320.
[183] City Code, *supra* note 178, at B1.
[184] Elken, *supra* note 11, at 320-21.
[185] City Code, *supra* note 178, at G16, G17.

party's board of directors.[186] Rather, the Takeover Panel is granted authority as to the ultimate determination of whether a MAC has occurred in a particular transaction.[187] In other words, an acquiror under a U.K. merger agreement would not be able to unilaterally terminate the deal based on its subjective assessment that a MAC has occurred. In addition, Rule 13.4 relates more specifically to pre-closing conditions such as MAC clauses, providing:

> An offeror should not invoke any condition or pre-condition so as to cause the offer not to proceed, to lapse or to be withdrawn unless the circumstances which give rise to the right to invoke the condition or pre-condition are of material significance to the offeror in the context of the offer.[188]

Thus, Rule 13.4, in effect, limits the ability of acquirors to walk-away from transactions by appending all qualifying conditions to closing by the concept of "materiality," whether or not such provision is actually qualified by the definition of MAC under the terms of the contract.

Furthermore, the structure of MAC clauses in British public merger agreements differs from their U.S. counterparts in that, as a result of the regime established by the Takeover Panel, they lack the highly negotiated MAC exceptions characteristic of MAC clauses in the U.S.[189] Thus, MAC clauses in the U.K. are relatively uniform and resemble the traditional MAC clause in the U.S. prior to the development of its modern incarnations.[190] A typical MAC clause in a British public merger agreement might read: "[save as publicly disclosed] no adverse change or deterioration having occurred in the business, assets, financial or trading position or profits or prospects or operational performance of an member of the Group which in any

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[186] *Id.* at G16.
[187] *Id.* at G16, G17.
[188] *Id.* at G17.
[189] Elken, *supra* note 11, at 321.
[190] *Id.* at 322.

case is material in the context of the wider Group taken as a whole."[191]

B. *Tempus Group PLC v. WPP Group PLC*

The seminal case interpreting a MAC provision under British law arose in 2001 when the advertising firm WPP Group PLC ("WWP") attempted to walk-away from its acquisition of its industry competitor, Tempus Group PLC ("Tempus").[192] One day prior to the terrorist attacks of September 11, 2001, WPP posted an offer to purchase all remaining outstanding Tempus stock.[193] After the attacks, WPP approached the Takeover Panel for a ruling as to whether, under the term of the City Code, WPP could invoke its termination rights under the agreement's MAC clauses due to the turbulent economic conditions that followed.[194] The Takeover Panel rejected WPP's claim, holding that excuse under a MAC provision "requires an adverse change of very considerable significance striking at the heart of the purpose of the transaction in question, analogous . . . to something that would justify frustration of a legal contract."[195] In reaching this holding, the Takeover Panel cited a 1974 statement issued during a time of similarly turbulent economic conditions, which provided that unless the above test is satisfied, "a change in economic, industrial or political circumstances will not

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[191] Jeffrey Rothschild, Nick Azis, Patrice Corbiau, Dennis White & Abigail Reed, *Drafting Material Adverse Change Clauses*, MCDERMOTT, WILL & EMERY, at 3, http://www.mwe.com/info/pubs/draftingmaterial.pdf.

[192] THE TAKEOVER PANEL, OFFER BY WPP GROUP PLS FOR TEMPUS GROUP PLC, at ¶ 1 (Nov. 6, 2001), *available at* http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/2001-15.pdf [hereinafter Offer by WPP for Tempus Group].

[193] *Id.* ¶ 5.

[194] *Id.* ¶ 7. The MAC clause in the Tempus/WPP merger agreement was structured as a condition to closing, providing: "since 31 December 2000 and save as disclosed in the accounts then ended and save as publicly announced in accordance with the Listing Rules by Tempus prior to 20 August 2001 and save as disclosed in this document or as otherwise fairly disclosed in writing by Tempus to WPP: (i) no material adverse change or deterioration having occurred in the business, assets, financial or trading position or profits or prospects of any member of the wider Tempus Group." *Id.* ¶ 8(g) (emphasis omitted).

[195] *Id.* ¶ 16.

normally justify the withdrawal of an announced offer."[196] Based on that statement, the Takeover Panel reasoned that while the economic impact of September 11, 2001 were "exceptional" and "unforeseeable" and clearly contributed to the market declines already impacting advertising, it nonetheless did not undermine the rationale behind WPP's desire to enter into the merger agreement nor the price of its offer.[197]

In response to criticism generated by the decision, in 2001, the Takeover Panel both codified and clarified the standard established in *Tempus*, indicating that a MAC does not actually have to rise to the level of legal frustration of contract, however, reaffirming that the threshold for invoking a MAC clause remains "a high one" and that the material change asserted still must be "very considerable significance striking at the heart of the purpose of the transaction."[198]

C. *Comparing the British Approach to U.S. Law*

The most fundamental difference between the U.S. and British Approach to MAC clauses lies in the very existence of the Takeover Panel and City Code's general principles of fairness, openness and equality among shareholders.[199] In the U.S., there is no equivalent administrative body injecting such public policy into the market for mergers.[200] Furthermore, in the U.K., the public policy embodied in the City Code creates a strong presumption that the acquiror assumes the risk associated with unexpected events.[201] In contrast, U.S. courts have recognized no such public policy presumption, and rather, have relied exclusively on contract law and the intent of the parties as expressed in determining which party

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[196] *Id.* ¶ 13 (emphasis omitted).
[197] *Id.* ¶ 19.
[198] *Id.* ¶ 16.
[199] Nick Cline & Richard Trobman, *Comparing the Value of US and UK Mac Clauses*, 21 INT'L FIN. L. REV. 20 (2002).
[200] *Id.* at 20 (noting that the closest equivalent to the Takeover Panel and the City Code's public policy in the U.S. is likely the Securities and Exchange Commission's policy against subjective offer conditions in tender offers, which, in practice, is not taken into consideration by U.S. courts interpreting MAC provisions).
[201] *Id.*

should bear such risk.[202] Finally, in the U.S., a MAC clause is not subject to any industry or economic specific carve-outs, unless specifically bargained for, whereas the City Code incorporates such carve-outs whether or not bargained for, as discussed above.[203]

VIII. IS THERE A WAY TO MITIGATE THE UNCERTAINTY GENERATED BY U.S. MAC CLAUSES?

Given the limited practical utility of MAC clauses as a mechanism for walking away from a transaction, as well as the uncertainty generated by MAC provisions in the U.S. market for mergers, there appears to be a cognizable necessity to rework the fundamental approach taken in drafting such provisions. While no one system is without criticism, both the U.S. case law and the British approach to MAC clauses provide useful lessons for the drafting attorneys and the contracting parties to a merger agreement.

A. Interpretive Solutions: The Risk/Uncertainty Dichotomy

In his paper, "On Uncertainty, Ambiguity, and Contractual Conditions," Eric Talley attempts to establish a useful paradigm for understanding the rights associated with MAC clauses in the context of recent Delaware case law.[204] Talley posits that, distinct from parties' assessment of risk is their assessment of the potential uncertainty, or ambiguity, associated with a given transaction.[205] In line with recent economic and financial literature, Talley argues that while "'[r]isk' refers to randomness whose probabilistic nature is extremely familiar and can be characterized with objective probabilities . . . [while] '[u]ncertainty,' in contrast, refers to randomness whose probabilistic behavior is extremely unfamiliar, unknown, or even unknowable."[206] Following this reasoning, Talley advances the notion that the extent of a party's "uncertainty-aversion" is based on how that party forms subjective beliefs or conjectures about

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[202] *Id.*
[203] *Id.*
[204] *See* Talley, *supra* note 5.
[205] *Id.* at 759.
[206] *Id.*

unknown factors in its environment.[207] In the context of definitive merger agreements, Talley asserts that MAC clauses are the primary mechanism enabling parties to manage their own uncertainty-aversion and the overall ambiguity associated with a transaction.[208] By broadening the scope of a MAC clause, the weight of ambiguity is shifted to the target and, by narrowing it, to the acquiror.[209]

Talley's risk/uncertainty dichotomy has the potential to serve as a guiding principle for parties struggling to understand when it is appropriate to rely on a MAC clause. For example, Strine's rationale that the materiality of an adverse change to a target's business prospects must be viewed in the long-term, rather than the short-term,[210] supports the notion that MAC clauses are more appropriately relied on for the management of ambiguity rather than risk. Thus, if acquirors intend for a more familiar risk to trigger their right to walk away, that right should be specifically contracted for in a clause other than the contract's MAC provision.

Furthermore, the practical complications associated with negotiating specificity into a traditional MAC provision counsels parties to manage short-term risk through other contract provisions, the most obvious choice being representations and warranties. For example, in *IBP, Inc. v. Tyson Foods, Inc.*, there were several alternative contract mechanisms available to the parties which were likely better suited for the management of short-term risk and thus, could have potentially better protected Tyson from the risk that IBP's first quarter earnings would fall.[211] The parties might, for example, have included a warranty by the target that its earnings in a particular quarter will not fall below a specified amount. Of course, specifying such an amount in a warranty might create further expense and complications in negotiation. However there may be some significant advantages to restricting the management of such risk to representations and warranties. First, this approach may limit the possibility that a court will interpret the parties' specificity as a signal to limit the scope of the separate and distinct rights granted in

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[207] *Id.* at 760.
[208] *Id.*
[209] *Id.*
[210] *See, e.g.*, IBP, Inc. v. Tyson Foods, Inc., 789 A.2d 14, 68 (Del. Ch. 2001).
[211] *Id.* at 69-70.

a MAC clause. Second, by restricting the management of more familiar risk to other contract provisions, in line with the court's reasoning in *IBP*, the parties leave their MAC clause to appropriately serve "as a backstop protecting the acquiror from the occurrence of *unknown* events",[212] or the management of uncertainty.

However, as Talley recognizes, it remains unclear whether courts analyzing merger agreements actually treat risk differently than uncertainty when analyzing whether an event falls under the parameters of a MAC clause.[213] Thus, while the distinction may be theoretically sound, in practice, parties should be cautious when evaluating an event under the risk/uncertainty dichotomy.

B. Proposed Drafting Solutions

As discussed above, it remains unclear what circumstances would be sufficient for the Delaware Chancery to excuse an acquiror's obligations under such a provision. Thus, rather than speculating as to the types of scenarios which might be held to constitute a MAC, it is more productive for parties entering merger agreements, and attorneys drafting MAC clauses, to consider alternative ways of drafting MAC clauses in order to maximize their effectiveness in accomplishing the intent of the parties.

(i) Providing Specific Benchmarks for "Materiality"

As reflected by Delaware case law, it appears that MAC clauses as currently drafted in the majority of U.S. merger agreements will nearly always be held to be ambiguous.[214] Thus, the court is required to look to other parts of the contract, as well as outside the contract, in order to determine the underlying intentions of the parties. Therefore, unless the overall approach to drafting such provisions is modified by practitioners, the most important guiding principle behind that modification must be specificity in drafting in order for it to accomplish with certainty the goal of the parties in negotiating a MAC provision.

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[212] *Id.* at 68 (emphasis added).
[213] Talley, *supra* note 5, at 786-87.
[214] *Supra* Part III.

One potential option is for U.S. acquirors to include specific quantitative or qualitative benchmarks, indicating that a decline in earnings (or other economic indicator) of a delineated amount over a specified period, or the occurrence of a specific class of events, should be considered "material" in the context of a MAC provision. However, practitioners have resisted such specificity, likely because it has the potential to create some significant problems in both negotiation and litigation. First, reaching an agreement on such guidelines could lead to significant expense and could potentially complicate negotiations to the demise of the transaction. Second, providing a dollar amount could lead an interpreting court to construe an intention of the parties to limit events triggering a MAC clause to that amount at a minimum. This is problematic for acquirors basing their negotiation on the amount of their expectations at the time of the contract's execution and the projections of investment bankers or other intermediaries, both of which are subject to change by the time the acquiror attempts to invoke the protections of the provision.

Finally, perhaps the greatest practical concern in providing qualitative guidelines is that such specificity leads courts to exclude events not contemplated by those guidelines from the scope of the provision, as occurred in the French case discussed above. However, it is likely that such risk could be limited by providing for an "including, without limitation" proviso to such benchmarks. While this is no guarantee against the possibility that a court will nonetheless narrow the scope of the clause based on the examples provided, it nonetheless seems the better course of action when compared to the alternative option of facing courts that have never found an event sufficient to constitute a MAC.

In their book, The Art of M&A: A Merger/Acquisition/ Buyout Guide, Stanley Foster Reed, Alexandra Reed Lajoux, and H. Peter Nesvold query the possibility of including a "basket amount" as a mechanism for quantifying materiality in merger agreements.[215] A "basket," as more commonly used in merger agreements, is a highly negotiated dollar amount set as a minimum loss a party must suffer in order to recover damages under an indemnification

[215] REED ET AL., *supra* note 1, at 487.

provision.[216] Reed, Lajoux, and Nesvold suggest that, because the more standard basket amount has little or nothing to do with the concept of materiality in merger agreements, parties may want to consider including a negotiated and distinct basket amount to be incorporated into the definition of MAC.[217] As a practical matter, including a basket amount in connection with a MAC provision is likely the more prudent course of action, as opposed to negotiating individual threshold amounts for specific types of events.

(ii) Drafting MAC Clauses as a Mechanism for Restructuring

In its persistent rejection of attempts by acquirors to walk away from merger transactions under MAC provisions, the Court of Chancery has expressed a general preference for enforcing contractual obligations. This preference is likely motivated, at least in part, by the court's desire to maximize economic efficiency and minimize overall transaction costs. When an acquiror walks away, the target is often left in a worse position than it was in at the outset. This is compounded by the likelihood that the target has turned away other bidders as a result of its contractual obligations to the former acquiror. Furthermore, mergers often demand the attention of key personnel essential to the target's day-to-day operations, thus slowing the pace of the target's normal operations. The acquiror's shareholders may suffer losses as a result of the expense (in terms of both time and money) of due diligence and negotiation with respect to the failed transaction. As Talley points out, from an economic perspective, where adverse events constitute "more moderate levels of uncertainty, closing the deal likely remains efficient, albeit on restructured terms that are responsive to new information about ambiguity."[218] Thus, it makes economic sense for MAC clauses to be drafted to trigger a pre-negotiated restructuring of an original deal, rather than terminating it entirely (similarly to the concept of earn-out provisions).

However, the proposition that parties might be able to contract ahead of time for a restructuring of a transaction upon the

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[216] *Id.*
[217] *Id.* at 489.
[218] Talley, *supra* note 5, at 788.

occurrence of an unknown event is a highly theoretical proposition. Perhaps the primary limitation of such an approach is that due to the very nature of ambiguity, parties may not know, and may not even be able to speculate at the time of contracting, what deal terms they would be willing to agree to after the occurrence of some future unknown event. Nonetheless, it may be possible in theory for creative lawyers and businessmen to delineate a means of categorizing either the adverse events themselves, or perhaps more realistically, the extent of the adverse effect of such events. However, this notion in turn raises another potential limitation. Even if such a system of categorization were devised, there would inevitably remain events and effects that may be too unlikely to justify the costs associated with pre-negotiated contingencies, or alternatively, that are simply impossible to contemplate in advance. Still, there may be ways to work around such limitations. For example, the parties could include a "catch-all" provision whereby unanticipated events or changes trigger a more open-ended form or restructuring, such as a requirement that the parties agree to negotiate in good faith for a specified period of time.

Such limitations aside, there are several potential benefits to this alternative approach. First, it would limit the economic waste that results from the alternative scenario of terminating the deal. Second, it may serve to minimize the chances of litigation. If the consequences of triggering a MAC provision are less severe, targets may be more resistant to incurring the costs of litigation than to proceeding with a pre-negotiated restructuring. Furthermore, if a dispute regarding whether the provision has been triggered results in litigation, the court would presumably look more favorably on an acquiror's request that the court affect a pre-negotiated restructuring than it would on a request to excuse contractual obligations. Rather than being faced with the more extreme options of either specific performance or rescission, the court would also have the more palatable option of affecting an agree-to restructuring of the original agreement, thus maximizing the possibility of a favorable outcome for the acquiror.

(iii) Arbitration by Financial Experts

Finally, the concept of the U.K. Takeover Panel may in and of itself provide useful lessons for U.S. merger and acquisition practitioners. Whereas judges may not be versed in certain particularities effecting specific industries or securities markets as a whole, a panel of financial experts may be in a better position to evaluate a MAC dispute than would a panel of judges. Thus, if the parties agree at the time of contracting that this is indeed likely to be the case based on the nature of their transaction, they might consider negotiating a dispute resolution clause calling for binding arbitration by a panel of financial experts and agreeing to the identity of those experts at the time of contracting.

C. Proposed Legislative and Administrative Solutions

As discussed above, while not without its own flaws, the British approach of providing administrative guidelines for parties drafting MAC provisions in merger agreements may provide useful lessons for policymakers in the U.S. Parties to merger agreements in the U.S. have been extremely reluctant to include specific benchmarks when defining the term "MAC" in merger agreements. This phenomenon is likely primarily the result of concerns that such benchmarks will cause courts to construe such specificity as the intent of the parties to exclude events that fall outside the parameters of those benchmarks from the definition of MAC. In light of the reluctance of parties to modify their approach to drafting MACs, and given the negative public policy consequences that have resulted from the current U.S. approach, U.S. policy makers should consider the possibility of clarifying the concept of "materiality" through statute or administrative code. Such a legislative approach wuld likely be desirable from the perspective of both acquirors and targets looking for certainty in contracting, while eliminating the potential for courts to narrowly construe MAC clauses that include specific benchmarks negotiated by the parties.

IX. CONCLUSION

This Article has argued the existing approach to drafting MAC clauses in the U.S. has proven unworkable in practice, and thus, that a fundamental reevaluation of how MAC clauses are drafted in merger agreement is warranted. Unless such a reevaluation is undertaken, it is likely that U.S. courts will continue to refuse to allow parties to invoke termination rights under MAC clauses in virtually any circumstances, and parties will continue to face the negative market conditions discussed in Part V above.