BANKING ON CORPORATE

A MEAL OF MATERIAL ADVERSE CHANGES

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The term "MAC" appears, it seems, as often in M&A transaction agreements as it does in McDonald's restaurants worldwide. The difference, likely because of phenomenal marketing, is that virtually everyone knows what is in a Big Mac, but the concept as used in M&A (where it refers to a "material adverse change") is less well understood. So, when courts provide insight into the meaning of material adverse change, it receives a lot of attention, a satisfying MACnugget of guidance.

The recent decision in *Akorn, Inc. v. Fresenius Kabi AG, et al.* has received much attention not only for this reason but because it is the first time that the influential Delaware courts have permitted a buyer to terminate a pending M&A transaction based on a MAC. In previous decisions, the bar had been set very high. Staying with the fast food theme, the common understanding was that for a development to constitute a material adverse change, it had to be a real whopper.

> ***"There is some irony in making fast food allusions about a court decision that runs 246 pages . . ."***

The purchase agreement between Fresenius Kabi AG, a German pharmaceutical company, and U.S.-based drug maker Akorn, Inc. was, in relevant respects, typical. Akorn made detailed representations about its business, and Fresenius' obligation to close was conditional on, among other things, no Akorn "material adverse effect" (or MAE, a functional synonym for MAC) having occurred and Akorn's representations being true and correct except where the failure to be true and correct would not reasonably be expected to have an MAE. The definition of MAE itself was in generally standard form in two core respects. First, it did not articulate specific characteristics of materiality or set quantitative thresholds. Instead, it referred generally to matters that would have a material adverse effect on the business, results of operations or financial condition of the company. Second, it included a detailed list of exceptions that effectively divide the risk of an MAE between the purchaser and the seller. The purchaser takes on systemic risks (affecting the entire industry or economy), indicator risks (such as changes in stock price or credit rating that may indicate an MAE but aren't considered MAE's in themselves) and agreement risks (consequences of the transaction itself). Risks relating to the business, on the other hand, stayed with the seller.

To say that the concept of MAC or MAE is rarely defined will sound odd to those who negotiate M&A agreements. We're accustomed to thoughtful debates where the seller takes the risk of an MAE, except where there is an industry downturn, except where the industry downturn is disproportionately suffered by the seller, except where that proportionality is consistent with historical trends, except where the seller triggered the industry effect . . . There is a lot of sitting around the table asking who is helped by the latest exception. At its core the concept is undefined, however, which leaves the task of giving MAC meaning to the courts.

The *Akorn* case did not much change the test applied in earlier cases; the court just came to a different conclusion. In *Akorn,* the court found that, right after signing the merger agreement, Akorn's business "dropped off a cliff" for reasons specific to Akorn that were expected to be "durationally significant." Previous cases had involved significant declines in financial performance metrics, but, in Akorn, there were no signs of stabilization or abatement, and the results were not consistent with the company's historical performance patterns. Concerns about Akorn's business were compounded by data integrity concerns, of critical importance to a drug company. One expert testified that the compliance issues were so fundamental that they would be unexpected in a company that manufactured Styrofoam cups. The court found that the remediation costs for the compliance issues alone would add up to about 20 per cent of the company's value.

The court also rejected some novel arguments by Akorn, including that analysis of MAE should consider the synergies of the proposed merger and that an MAE cannot have occurred if the purchaser would still profit from the merger. Akorn also pointed to the representations in the purchase agreement to argue that Fresenius knowingly accepted the relevant risks. This argument would put buyers in a bad place, where seeking representations about the target business would be considered acceptance of related risks. Ultimately, the Akorn court stuck to the language of the agreement and rejected these arguments.

There is some irony in making fast food allusions about a court decision that runs 246 pages, with more to come as the decision has been appealed to the Delaware Supreme Court. For now, the lessons of the case are to confirm what courts have long said, namely that for something to be a MAC it must be a really big MAC, and there is now a fact pattern that has supported a finding of such a big MAC. The decision also shows the complexity and breadth of relevant factors, making clear the challenges of determining what in each case will add up to the necessary happy meal combination for a purchaser claiming a MAC.

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