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Practice Update

Considering MAE Provisions in M&A Agreements in Light of Coronavirus

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In the last few weeks, we have seen a variety of domestic and cross-border mergers and acquisitions (M&A) and private equity transactions move forward, but in some cases we have seen bid processes being put on hold and the slowdown of negotiations due to the outbreak of the coronavirus (COVID-19). Parties should carefully draft provisions of new agreements in light of the COVID-19 outbreak, but how about the impact on acquisition agreements that have already been signed?

In the context of M&A/private equity transactions, typical MAE (also called a material adverse change or MAC) provisions may allow a party to walk away from the transaction where there has been (or reasonably likely to have) an event or circumstance that would be materially adverse to the business, results of operation or financial condition of the target company and its subsidiaries following the signing date. Depending on the contractual provisions, a party may be allowed to terminate the agreement if the current circumstances render a condition to closing impossible, including conditions that there have been no MAE, that a bringdown of representations and warranties are true and correct (as qualified by materiality or MAE) or that no covenants have been breached. These provisions are heavily negotiated and carefully drafted by the parties. So it is essential that the parties consider any

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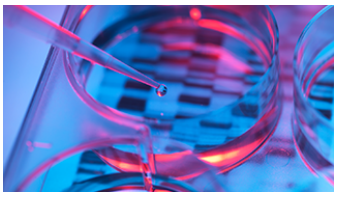

impact by COVID-19 and perform a careful review of the language of these provisions.

In a number of civil law countries, the affected party could invoke a *force majeure* type doctrine even when an MAE provision is not available. Click here to see our alert on *force majeure* provisions. In civil law countries (subject to review of applicable statutes), the doctrines of "hardship," "change of circumstance" or sometimes called "excessive burden" would normally allow a court to revise contracts if (i) there is an unforeseeable event (ii) that causes changes to the fundamental assumptions upon which the parties relied when they entered into the contract, (iii) so that the continued performance of the contract becomes excessively burdensome to one party to the advantage of the other party or excessively inequitable to the affected party.

In common law countries, such as the United States, courts will generally recognize the agreement by parties in respect of *force majeure* or MAE provisions. What constitutes the trigger of an MAE clause is highly negotiated between the parties and will depend on the specific language of the agreement. The parties to an M&A agreement (whether buyer or seller) involving a target that has been negatively impacted by COVID-19 should take the following steps:

1. Analyze MAE provisions in the agreement, whether there are exclusions or carve-outs that limit the applicability of an MAE (whether specifically mentioning "epidemic," "pandemic," "illness," "disease," etc. or other exclusions that a buyer or seller could rely on, such as "government action", "national or regional emergencies", "national calamity," etc.).
2. Determine the extent of the impact of COVID-19 outbreak on the target company (depending on the specific language, normally, on the company and its subsidiaries taken as a whole).

3. Determine if the MAE condition to closing would be triggered or there are breaches of other provisions such as representations and warranties that would make a bringdown condition to closing unachievable or that covenants have not been performed and complied with that are required to be performed and complied with (subject to materiality qualifiers) by closing.
4. Determine best course of action (terminate or negotiate revised terms). If the parties decide to renegotiate the terms, as many middle market M&A transactions in the United States are insured by representation and warranty insurance (RWI) it is important to confirm whether certain risks will be excluded from RWI and, if so, how the risks are reallocated between the parties.

Normally, MAE provisions are drafted in a way that would require a high threshold before they can be triggered. It is also normally a last resort. Historically, courts in Delaware, New York and other states have treated material adverse changes to a very high standard and have rarely decided that the MAE provision has been triggered. When ruling in favor of an affected party, courts have typically ruled that the material adverse effect has to be material to the agreement as a whole, durationally significant and the burden of proof is of the party invoking the MAE. For example, in *Akorn, Inc. v. Fresenius Kabi Ag*,[1] a 2018 case believed to be the first decision of a Delaware court that allowed a buyer (in this case Fresenius) to terminate an acquisition agreement due to the occurrence of an MAE, the Delaware Chancery Court determined that there was a significant deterioration of the business between signing and closing that threatened the fundamentals of the deal and that the effect should "substantially threaten the overall earnings potential of the target in a durationally-significant manner."[2] The Court emphasized in analyzing the MAE provision that the parties can allocate risks. Although "pandemic" was not the cause of MAE in the Akorn case, the Akorn Court made a clear

distinction based on the MAE language that Akorn retained the business risk whereas Fresenius accepted the systematic risks related to acts of war, violence, pandemics, disasters, and other *force majeure* events. The Court further stated that each of these allocations is subject to a disproportionate-effect exclusion that returns the risk to Akorn to the extent that an event falling into one of these categories disproportionately affects Akorn "as compared to other participants in the industry."[3] Applying *Akorn*, the Delaware Chancery Court in *Channel Medsystems Inc. v. Boston Sci. Corp.*[4] in 2019 stated that "Boston Scientific failed to demonstrate any material decline in Channel's value"[5] and ruled that a MAE provision had not been triggered. In a recent 2020 New York case, *Newmont Mining Corp. v. AngloGold Ashanti Ltd.*,[6] the United States District Court for the Southern District of New York distinguished Newmont from Akorn by stating that "[n]ot only was *Akorn* decided under Delaware law, which differs from the New York authority discussed above, but the factual circumstances differed as well. Unlike in *Akorn*, where the target experienced significant year-over-year declines in performance, causing the Delaware Chancery Court to note that its business performance 'fell off a cliff,' Newmont has not adduced evidence to show that the *Mine as a whole* suffered from a materially adverse effect-let alone an adverse effect that impacted the entire business to the extent that the MAE did in *Akorn*."[7]

For contracts that are being drafted now, the parties should carefully consider the specific terms of MAE provisions, representations and warranties and covenants to protect themselves and reflect the intent of the parties with respect to the current and future uncertain effects of the COVID-19 outbreak.

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[1] No. 2018-0300-JTL, 2018 WL 4719347, at *63 (Del. Ch. Oct. 1, 2018). In *Akorn*, the Court found that Akorn was unable to satisfy the closing condition requiring that all of its representations be true and

correct as of the closing date except where the failure "would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect."

[2] *Id.* at *53.

[3] *Id.* at *52.

[4] No. 2018-0673-AGB, 2019 WL 6896462 (Del. Ch. Dec. 18, 2019).

[5] *Id.* at *34.

[6] No. 17-CV-8065 (RA), 2020 WL 1285543 (S.D.N.Y. Mar. 18, 2020).

[7] *Id.*
