BRINGING DOWN THE DEAL: REEVALUATING THE DELAWARE MAE STANDARD AFTER *AKORN V. FRESENIUS*

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I. INTRODUCTION

For better or for worse, public corporations keep combining.[1] Successful mergers and acquisitions (M&A) brought us Whole Foods discounts with Amazon Prime and cross-posting to Facebook and Instagram.[2] Through buying an airline ticket, renting a car, or grabbing a beer, most people have recently interacted with companies that came out ahead in an M&A transaction.[3] While the combination process seems to happen quickly, signing a contract is far from the final step. Between executing an agreement and closing the deal, an enforceable contract binds the parties.[4] Therefore, contracts must address any hazards that could threaten the target company before closing, commonly known as deal risk.[5] Parties frequently mitigate deal risk

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1 *See generally Parks & Recreation: The Johnny Karate Super Awesome Musical Explosion Show* (NBC television broadcast Feb. 17, 2015) (announcing in a parody advertisement that a Verizon-ExxonMobil-Chipotle merger yielded "Veroxxotle," "proud to be one of America's 8 companies").

2 Jeffrey Dorfman, *Amazon and Whole Foods Merger to Introduce Cross-Platform Selling and Lower Prices*, FORBES (Aug. 25, 2017), https://www.forbes.com/sites/jeffreydorfman/2017/08/25/amazon-and-whole-foods-merger-to-introduce-cross-platform-selling-and-lower-prices/#7e4de4e312f8; *Why Instagram Is Worth $1B to Facebook*, FORTUNE (Apr. 10, 2012), https://fortune.com/2012/04/10/why-instagram-is-worth-1b-to-facebook.

3 *See, e.g.*, *Last Week Tonight with John Oliver: Corporate Consolidation* (HBO television broadcast Sept. 24, 2017).

4 Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2015 (2009). In public company combinations, this interim period can extend for a year or more. *Id.* Common sources of delay include due diligence, antitrust certifications, shareholder approvals, and regulatory inquiries. Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 335 (2005).

5 Miller, *supra* note 4, at 2013.

through bring-down conditions.[6] In a standard bring-down condition, the seller first represents and warrants certain information that must be true at signing.[7] The seller then brings down, or reaffirms, those representations and warranties when the buyer tenders the purchase price.[8]

In so allocating deal risk,[9] almost every[10] merger agreement includes a material adverse effect (MAE)[11] clause to give teeth to the bring-down conditions.[12] If the seller cannot—or will not—rectify a failed bring-down condition, which failure would reasonably be expected to have an MAE, before any applicable cure period expires, the buyer can invoke the MAE clause and refuse to close.[13] Until 2017, there was just one issue for parties who, like most,[14] chose Delaware law: no court had ever excused a buyer's closing obligations due to an MAE.[15]

6 *Id.*

7 Miller, *supra* note 4, at 2036.

8 Akorn, Inc. v. Fresenius Kabi, AG, No. 2018–0300–JTL, 2018 Del. Ch. LEXIS 325, at *145 (Del. Ch. Oct. 1, 2018) ("[I]t is standard practice to . . . condition the buyer's obligation to close on the seller's representations also being true at closing."), *aff'd en banc*, 198 A.3d 724 (Del. 2018); LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS, § 1.05[4], at 1–41 (2018 ed.); *cf.* Cobalt Operating, LLC v. James Crystal Enters., No. 714-VCS, 2007 Del. Ch. LEXIS 108, at *89 (Del. Ch. Jul. 20, 2007) ("Due diligence is expensive and parties . . . often negotiate for contractual representations that minimize a buyer's need to verify every minute aspect of a seller's business.").

9 *Akorn*, 2018 Del. Ch. LEXIS 325, at *113 n.530 (citing Miller, *supra* note 4, at 2013 n.7).

10 *E.g.*, Andrew Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 818 (2010).

11 An alternate term, "material adverse change," is essentially synonymous. *Akorn*, 2018 Del. Ch. LEXIS 325, at *111 n.524 (Del. Ch. Oct. 1, 2018), *aff'd en banc*, 198 A.3d 724 (Del. 2018); Gilson & Schwartz, *supra* note 4, at 331. *But see* Kenneth A. Adams, *A Legal-Usage Analysis of "Material Adverse Change" Provisions*, 10 FORDHAM J. CORP. & FIN. L. 9, 10–11 (2004) (arguing that "material adverse change" affords greater clarity).

12 Jeffrey Manns & Robert Anderson, *The Merger Agreement Myth*, 98 CORNELL L. REV. 1143, 1153 (2013).

13 *Akorn*, 2018 Del. Ch. LEXIS 325, at *145–46; KLING & NUGENT, *supra* note 8, at § 11.04[9].

14 More public companies incorporate in Delaware than in any other state. Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 59 (2018). One possible explanation for this preference is that "Delaware's preeminence in corporate matters makes its court the standard by which to judge all other such courts." Rochelle C. Dreyfuss, *Forums of the Future: The Role of Specialized Courts in Resolving Business Disputes*, 61 BROOK. L. REV. 1, 3 (1995).

15 Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008); *see also* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 Del. Ch. LEXIS 223, at *63–64 (Del. Ch. Oct. 31, 2014) (acknowledging that an MAE may have occurred but ruling on alternate grounds).

This Comment will examine recent developments in Delaware MAE precedent and the potential ramifications from those developments. Part II will provide background information on MAE interpretation and review the three seminal Delaware decisions which shaped the accepted three-part MAE standard. Part III will analyze how the Delaware MAE standard applied to the facts presented in *Akorn, Inc. v. Fresenius Kabi AG*.[16] Part IV will predict applications of the *Akorn* standard, focusing specifically on how the quantitative and qualitative findings made in that case may affect future MAE cases, alter the drafting process, and shift interpretation bias. Part V will propose a new conduct/intent standard for qualitative MAE analysis and argue that future decisions should avoid biased interpretation. Finally, Part VI will conclude that Delaware courts applying *Akorn* should specify a party-neutral qualitative MAE standard.

II. DELAWARE PRECEDENT AND THE SELLER-FRIENDLY POLICY

Pre-2018 Delaware jurisprudence developed a three-part MAE test and set forth a seller-friendly policy perspective to guide judicial review. This Part briefly summarizes (A) background information that can influence MAE interpretation, (B) *IBP*,[17] the seminal Delaware MAE case; (C) *Frontier Oil*,[18] the second major MAE decision; (D) *Hexion*,[19] the third pivotal opinion; and (E) the aggregate resulting MAE standard.

A. *Interpretational Considerations*

The million-dollar question in any MAE case is what, exactly, constitutes an MAE.[20] As discussed at length in Section V.B. below, narrow definitions rarely appear in contract language. Instead, parties often agree to a vague materiality standard. Courts faced with MAE claims must, therefore, decide whether parties meet that imprecise standard. In other words, MAE opinions consider how material an adverse effect must be before the buyer can walk away from the deal.

[16] Akorn, Inc. v. Fresenius Kabi, No. 2018–0300–JTL, 2018 Del. Ch. LEXIS 325 (Del. Ch. Oct. 1, 2018), *aff'd en banc*, 198 A.3d 724 (Del. 2018).

[17] *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14 (Del. Ch. 2001).

[18] Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 Del. Ch. LEXIS 57 (Del. Ch. Apr. 29, 2005).

[19] Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008).

[20] *See Frontier Oil*, 2005 Del. Ch. LEXIS 57, at *126 ("It would be neither original nor perceptive to observe that defining 'Material Adverse Effect' as a 'material adverse effect' is not especially helpful.").

It is well established that *material* in this sense connotates a higher bar than the standard used in typical contract interpretation.[21] The seminal Delaware MAE case adapted the federal securities regulation standard by considering whether an omitted fact would have influenced the decision-making process of a reasonable acquirer with the same total mix of information.[22] Later cases specified that materiality "varies both with the context of the transaction and with the words chosen by the parties."[23] Whatever the exact standard may be, materiality is a question of fact.[24] In making those factual findings, Delaware courts try to approximate what the parties intended when signing the agreement.[25] The parties' relative enthusiasm throughout the transaction typically receives scrutiny,[26] and post hoc MAE declarations have produced consistently negative results for buyers.[27] Put

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[21] *See* Schwartz, *supra* note 10, at 878. For example, factors toward determining material breach of contract include:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected; (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived; (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances; [and] (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

RESTATEMENT (SECOND) OF CONTRACTS § 241 (AM. LAW INST. 1981).

[22] *IBP*, 789 A.2d at 63 (citing TSC Indus. v. Northway, 426 U.S. 438, 449 (1976)).

[23] *Frontier Oil*, 2005 Del. Ch. LEXIS 57, at *127; *see* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 Del. Ch. LEXIS 223, at *63–64 (Del. Ch. Oct. 31, 2014) (demonstrating how context and circumstances shape MAE definitions).

[24] *Akorn*, 2018 Del. Ch. LEXIS 325, at *122; *see* Fecht v. Price Co., 70 F.3d 1078, 1081 (9th Cir. 1995) (quoting Durning v. First Boston Corp. 815 F.2d 1265, 1268 (9th Cir. 1987)) ("[O]nly if the adequacy of the disclosure or the materiality of the statement is 'so obvious that reasonable minds [could] not differ' are these issues 'appropriately resolved as a matter of law.'"). *But cf.* Parnes v. Gateway 2000, 122 F.3d 539, 546 (8th Cir. 1997) (holding that a misrepresentation is immaterial as a matter of law if it falls within common knowledge, concerns insignificant data, contains vague or hyperbolic language, or is accompanied by satisfactory cautionary statements).

[25] *See, e.g.*, Mrs. Fields Brand, Inc. v. Interbake Foods LLC, No. 12201-CB, 2017 Del. Ch. LEXIS 113, at *58 (Del. Ch. June 26, 2017).

[26] *See id.* Courts frequently analyze informal statements, internal memos, meeting minutes, and party recollections when questioning initial enthusiasm. *See generally* Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 724–30 (Del. Ch. 2008). This transactional timeline then considers when the buyer first suspected an MAE, the frequency with which the buyer mentioned an MAE, and when the MAE was finally claimed. *See generally id.*

[27] Gilson & Schwartz, *supra* note 4, at 356.

differently, the question becomes whether the buyer genuinely believes its own MAE claim, or whether it merely has buyer's remorse.

In answering that question, commentators have described MAE case law as inconsistent,[28] counterintuitive,[29] perplexing,[30] incoherent,[31] and downright scary.[32] Extensive factual findings produce behemoth opinions[33] that frequently reach unpredictable conclusions.[34] In pre-*Akorn* Delaware jurisprudence, three lower court decisions formed a three-part MAE test that considers magnitude and duration[35] through a seller-friendly policy lens.[36]

B. In re IBP, Inc. Shareholders Litig. v. Tyson Foods, Inc.

The seminal Delaware MAE decision concerned a merger between buyer Tyson Foods, Inc. (Tyson) and seller IBP, Inc. (IBP).[37] Tyson and IBP could barely contain their enthusiasm for the deal, and the kickoff meeting went off so well that Tyson's CEO asked deal counsel to begin preparing an agreement right then and there.[38] The merger agreement, which was governed by New York law,[39] included bring-down conditions expressly warranting IBP's financials[40] and broadly

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28 Yair Y. Galil, *MAC Clauses in a Materially Adversely Changed Economy*, 2002 COLUM. BUS. L. REV. 846, 850 (2002).

29 Schwartz, *supra* note 10, at 825.

30 Galil, *supra* note 28, at 847.

31 Schwartz, *supra* note 10, at 825.

32 Symposium, *Negotiating Acquisitions of Public Companies*, 10 U. MIAMI BUS. L. REV. 219, 241 (2002) (statement of Richard Climan).

33 *See* Akorn, Inc. v. Fresenius Kabi, AG, No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325 (Del. Ch. Oct. 1, 2018) (246 pages), *aff'd en banc*, 198 A.3d 724 (Del. 2018); Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715 (Del. Ch. 2008) (130 pages); Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 Del. Ch. LEXIS 57 (Del. Ch. Apr. 29, 2005) (158 pages); *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14, 68 (Del. Ch. 2001) (190 pages).

34 *Compare* Raskin v. Birmingham Steel Corp., No. 11365, 1990 Del. Ch. LEXIS 194, at *14–15 (Del. Ch. Dec. 4, 1990) (50% decline in earnings over two consecutive quarters likely to constitute MAE) *with IBP*, 789 A.2d at 69 (64% decrease in quarterly earnings, not an MAE).

35 *See Hexion*, 965 A.2d 715 at 738.

36 *IBP*, 789 A.2d at 68.

37 *Id.* at 21.

38 *Id.* at 30.

39 *Id.* at 52.

40 *Id.* at 41–43. IBP warranted that, as of the time of contract execution and through deal closing, all statements filed with the SEC on behalf of itself and its subsidiaries contained no untrue statements of material fact. *Id.* at 42.

warranting against an MAE.[41] Ten days after contract execution, Tyson advisors learned that IBP had received a letter from the SEC raising crucial issues with IBP's prior year financial statements.[42] Further, during the subsequent fiscal quarter, an unusually harsh winter financially impacted both Tyson and IBP, with IBP's losses totaling roughly 64% of its standalone value.[43] Tyson nevertheless expressed its continued commitment to the deal.[44] But when Tyson's enthusiasm waned, the deal essentially imploded. Following a disappointing quarter of its own, Tyson decided not to proceed with the merger[45] and unilaterally terminated the agreement.[46] In resulting litigation, Tyson asserted that IBP's failed bring-down conditions had caused an MAE and excused Tyson's obligation to close.[47]

From the start, the court viewed Tyson's MAE claim suspiciously. Tyson had not even considered declaring an MAE before terminating the merger,[48] and the court preliminarily concluded that Tyson would not have considered a short-term drop in IBP's performance to be material when it signed the merger agreement.[49] The court went on to consider MAE declarations conceptually, arriving at the oft-quoted conclusion that

> the important thing is whether the company has suffered a[n] [MAE] in its business or results of operations that is consequential to the company's earnings power over a commercially reasonable period, which one would think would be measured in years rather than months. It is odd to think that a strategic buyer would view a short-term blip in earnings as material, so long as the target's earnings-

41 *Id.* at 42–43. The bring-down condition stated that IBP had not suffered "any event, occurrence or development of a state of circumstances or facts which has had or reasonably could be expected to have a[n] [MAE]." *Id.*

42 *IBP*, 789 A.2d at 43–44.

43 *Id.* at 47–48, 69.

44 *Id.* at 48.

45 *Id.* at 50. The decision came down from a secretive March 28, 2001, meeting of former executives known as the "old guard," including the CEO's father. *Id.* Then-present Tyson officials claimed that, prior to that meeting, they thought the deal was going forward. *Id.*

46 *Id.* at 50–51. The termination letter sent from Tyson to IBP contained no allegations of, or references to, IBP having suffered an MAE. *Id.* at 51.

47 *Id.* at 52–53. As previously mentioned, the merger agreement was governed by New York law. *Id.* at 52. Applying that choice of law, the court found that Tyson bore the burden of proving, by clear and convincing evidence, that IBP had sustained an MAE. *Id.* at 52–54.

48 *IBP*, 789 A.2d at 65.

49 *Id.*

> generating potential is not materially affected by that blip or the blip's cause.[50]

The court further considered "the longer-term perspective of a reasonable acquiror" when determining what Tyson had understood the contract to mean.[51] One abysmal quarter, the court reasoned, did not meet the materiality threshold because that disappointing quarter did not significantly inhibit IBP's long-term earnings potential.[52]

The decision also weighed a policy question: who should bear the burden of deal risk?[53] The court reasoned that broad MAE definitions are "best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally significant manner."[54] Under that seller-friendly policy perspective, Tyson failed to prove that IBP had suffered an MAE.[55] But this policy decision sparked debate among commentators who asked whether that interpretation reflected realistic expectations.[56]

C. Frontier Oil Corp. v. Holly Corp.

Three years later, the court revisited *IBP* in *Frontier Oil*.[57] This case concerned a long-anticipated[58] consolidation of Frontier Oil Corporation (Frontier) and Holly Corporation (Holly).[59] During negotiations, Frontier learned that its wholly-owned subsidiary faced possible mass tort litigation spearheaded by none other than Erin Brockovich.[60] Accordingly, Holly insisted that stronger language,

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50 *Id.* at 67.

51 *Id.* at 68.

52 *Id.* at 67 (characterizing IBP as "consistently profitable, but subject to strong [financial] swings").

53 *Id.* at 68.

54 *IBP*, 789 A.2d at 68.

55 *Id.* at 71. Then-Vice Chancellor Strine noted that the outcome would have been reversed if IBP had borne the burden of proving, to a clear and convincing standard, that an MAE had not occurred. *Id.* at 72 n.172.

56 *See* 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, 84 (2010); *see also* Galil, *supra* note 28, at 865; Schwartz, *supra* note 10, at 831; Sherri L. Taub, Note, *"Buyer's Regret" No Longer: Drafting Effective MAC Clauses in a Post-*IBP *Environment*, 24 CARDOZO L. REV. 849, 896–97 (2003).

57 Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 Del. Ch. LEXIS 57, at *127 (Del. Ch. Apr. 29, 2005).

58 The companies had informally discussed a consolidation for several years, with Frontier's CEO predicting that the combination would create "one incredible company." *Id.* at *3.

59 *Id.* at *2.

60 *Id.* at *7–8.

including a specific MAE bring-down condition,[61] be added to the consolidation agreement.[62] Shortly after contract execution, the threatened litigation materialized—with Frontier named as a direct defendant.[63] Protracted restructuring efforts ultimately failed during a heated conference call with a seeming eye toward litigation.[64] Frontier filed suit the next day, alleging that Holly had repudiated the agreement[65] and effectively precluded Holly from declaring an MAE.[66] Holly vehemently denied any such repudiation and counterclaimed that, in breach of Frontier's bring-down conditions, the mass tort litigation would reasonably be expected to have an MAE on Frontier.[67]

The court first adopted *IBP* as the rule under Delaware law, describing the standard as affording protection from "unknown (or undisclosed) factors that would justify an exit from the transaction."[68] The opinion acknowledged that future events could cause a present MAE[69] but emphasized that there must be some "basis in law and fact for the serious adverse consequences prophesied by the party claiming the MAE."[70] That basis, the court held, must be supported by objective qualitative and quantitative evidence.[71] In other words, Holly's

[61] *Id.* at *13–16.

[62] *Id.* The agreement defined an MAE, with respect to either party, as "a material adverse effect with respect to (A) the business, assets and liabilities (taken together), *results of operations*, condition *(financial or otherwise) or prospects* of a party and its Subsidiaries on a consolidated basis." *Frontier Oil*, 2005 Del. Ch. LEXIS 57 at *16 (emphasis in original).

[63] *Id.* at *38–40. Newly discovered documents indicated that Frontier had indeed contracted to indemnify that subsidiary. *Id.* at *45–46. Frontier had not known about the indemnities before signing the agreement; upon discovery, it was less than forthcoming with the information. *Id.* at *49.

[64] *Id.* at *59. Frontier's CEO asked whether Holly was rescinding the contract, to which he "clearly, unambiguously, directly, and unequivocally responded[,] 'No.'" *Id.* at *81–82. The court accepted Holly's protest that Frontier's CEO, a "straight-talking, boot-wearing Texan who does not speak legalese[,]" would not have used such language independently. *Frontier Oil*, 2005 Del. Ch. LEXIS 57 at *84. Unfortunately, the opinion did not suggest what language that CEO would conceivably have used.

[65] *Id.* at *86.

[66] *Id.* at *105.

[67] *Id.* at *89, *94–95.

[68] *Id.* at *128–29. The court conceded that Frontier may have breached the warranty against threatened litigation but emphasized that mere breach of warranty, absent a showing that such breach would reasonably be expected to have an MAE, did not sustain Holly's claim. *Id.* at *131.

[69] *Contra* S.C. Johnson & Son, Inc. v. DowBrands, Inc., 167 F. Supp. 2d 657, 670 (D. Del. 2001) ("The sole decision by a third party to bring a lawsuit does not bring about any change in the company's assets, unless and until a court adjudicates the claim in favor of the third party . . . .").

[70] *Frontier Oil*, 2005 Del. Ch. LEXIS 57, at *137 n.224.

[71] *Id.* at *142.

predictions could excuse its closing obligations if, but only if, Holly produced concrete facts suggesting that the mass tort litigation would end badly for Frontier. Ultimately, Holly did not prove those facts and failed on its MAE claim.[72] First, a finding for the mass tort plaintiffs was not guaranteed, and a judgment arising from any such finding was similarly unpredictable.[73] Further, Holly presented no expert opinions supporting its prediction that Frontier would lose the mass tort litigation.[74] Absent legal and factual evidence, the court found Holly's MAE declaration overly speculative and without merit.[75]

D. Hexion Specialty Chems., Inc. v. Huntsman Corp.

This case concerned an acquisition of Huntsman Corporation (Huntsman) by Hexion Specialty Chemicals, Inc. (Hexion).[76] Hexion's winning bid for Huntsman ousted a competitor with whom Huntsman had already contracted,[77] so Huntsman enjoyed significant bargaining power.[78] That advantage produced final terms so favorable to Huntsman that the MAE clause formed Hexion's only practicable escape hatch.[79] The parties also agreed to uncapped damages should Hexion knowingly or intentionally[80] breach any contract term, and $325 million in liquidated damages for any other breach.[81] In other words, if Hexion decided to jump ship, it would be on the hook for at least $325 million—unless it could prove an MAE. So, Hexion was in a tough spot when Huntsman's first-quarter financial reports significantly missed

72 *Id.* at *136–37.

73 *Id.* at *136.

74 *Id.* The court speculated that this lack of expert testimony was not surprising since "[i]t might not be in Holly's self-interest, as a participant in the petroleum industry, to champion the cause of linking exposure to petroleum (or petroleum products) to cancer." *Id.* at *136 n.221.

75 *Id.* at *143.

76 Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715 (Del Ch. 2008). Apollo Global Mgmt., LLC, Hexion's parent company, began acquisition negotiations with Huntsman in late 2005. *Id.* at 723. After substantial due diligence, Apollo abandoned the 2005 negotiations when Huntsman missed income projections. *Id.*

77 *Id.* at 724. Hexion initially showed tremendous enthusiasm for the Huntsman deal. *Id.* at 724–25.

78 *Id.*

79 *See id.* at 736–37. That clause narrowly carved out exceptions for economic and industry conditions. *Id.*

80 The court acknowledged that "knowingly" and "intentionally" are not terms typically used in contract law, but held that a "'knowing and intentional' breach . . . is the taking of a deliberate act, which act constitutes in and of itself a breach of the merger agreement, even if breaching was not the conscious object of the act." *Id.* at 747–48.

81 *Id.* at 724.

projections.[82] Without notifying Huntsman, Hexion obtained and published an opinion stating that the combined company would be insolvent.[83] Concurrently, Hexion filed suit for a declaratory judgment that Huntsman had suffered an MAE.[84]

The *Hexion* court, relying on *IBP* and *Frontier Oil*, stressed the heavy burden assumed by buyers who cry MAE.[85] The court held that the party seeking to avoid performance under an MAE claim bears the burden of proof[86] and established the presumption that a buyer is purchasing a target company for long-term investment value.[87] The court noted that while a severe decline in the target's earnings may be an MAE, any such decline "must be expected to persist significantly into the future."[88] The evidence in this case showed that Huntsman's financial decline affected only two divisions of the company, which had been expected to generate a mere 25% of Huntsman's annual earnings before income tax, depreciation, and amortization (EBITDA).[89] Moreover, the court looked critically at Hexion's prepared insolvency opinion and found its credibility lacking.[90] Yet again, apparent buyer's remorse could not overcome the seller-friendly policy, and Hexion's MAE claim met a familiar demise.

E. *Aggregating the Pre-Akorn Standard*

Taken together, *IBP*, *Frontier Oil*, and *Hexion* solidified the Delaware MAE standard. *IBP* established the seller-friendly policy[91] and treated a broad MAE condition as a backstop such that the buyer gained protection from (i) unknown events (ii) which substantially threaten the target's overall earnings potential (iii) in a durationally significant way.[92] *Frontier Oil* posited that contemplated future effects with some basis in law and fact might constitute a present MAE.[93] Finally, *Hexion*

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82 *Hexion*, 965 A.2d at 725 n.8. According to those reports, the 27% to 32% returns expected by Hexion had fallen to between 11% and 18%. *Id.*

83 *Id.* at 725. Although Hexion had no right to terminate the merger agreement for insolvency, it sought to frustrate financing and indirectly terminate the deal by publishing the insolvency opinion. *Id.* at 725–26.

84 *Id.* at 736.

85 *Id.* at 738.

86 *Id.* at 739.

87 *Id.* at 738.

88 *Hexion,* 965 A.2d 715 at 738.

89 *Id.* at 744–45.

90 *Id.* at 727.

91 *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14, 68 (Del. Ch. 2001).

92 *Id.*

93 Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 Del. Ch. LEXIS 57, at *137 n.224 (Del. Ch. Apr. 29, 2005).

established that the buyer presumptively bears the burden of proof[94] and that any negative financial projection relied upon to show an MAE must be reasonably expected to negatively affect the target's long-term future performance.[95]

As these cases demonstrate, the burden of disproving buyer's remorse is so massive that "[a] contractual [MAE] is like a Delaware tornado—frequently alleged but rarely shown to exist."[96] This approach conforms with Delaware's particular respect for contractarian theory[97] and sends a clear message: if a buyer wants an easier out, it should contract for one. But commentators criticized Delaware's uniformly seller-friendly record, finding that the standard deprived buyers of what was already in the contract: their bargained-for right to declare an MAE.[98]

III. CASE STUDY: *AKORN, INC. V. FRESENIUS KABI* AG

Ten years after *Hexion*, one Delaware opinion did the unthinkable by finding a seller who had, indeed, suffered an MAE so severe that it excused the buyer's closing obligations.[99] This Part explores (A) the case's factual background, including pre-signing conduct, specific bring-down conditions, and post-signing developments; (B) the court's findings that the seller had suffered an MAE under qualitative and quantitative thresholds; and (C) the opinion's affirmation on appeal.

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94 *Hexion*, 965 A.2d 715 at 739.

95 *Id.* at 742–43.

96 Chyronhego Corp. v. Wight, No. 2017-0548-SG, 2018 Del. Ch. LEXIS 258, at *22 (Del. Ch. July 31, 2018).

97 *See* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325, at *139 n.622 (Del. Ch. Oct. 1, 2018) (noting that Delaware law "is more contractarian than that of many other states"), *aff'd en banc*, 198 A.3d 724 (Del. 2018); *see also* Ev3, Inc. v. Lesh, 103 A.3d 179, 181 n.3 (Del. 2014) ("Delaware courts seek to ensure freedom of contract and promote clarity in the law in order to facilitate commerce."); Libeau v. Fox, 880 A.2d 1049, 1056 (Del. 2005) ("When parties have ordered their affairs voluntarily through a binding contract, Delaware law is strongly inclined to respect their agreement[.]"), *rev'd on other grounds*, 892 A.2d 1068 (Del. 2006); *cf.* Milford Power Co. v. PDC Milford Power, LLC, 866 A.2d 738, 748 (Del. Ch. 2004) ("Many sophisticated parties . . . sign contracts that have terms that might be considered onerous; [Delaware] law does not relieve them of the burden of those decisions simply because of their after-the-fact regrets.").

98 Brooks, *supra* note 56, at 84; Schwartz, *supra* note 10, at 828.

99 *Akorn*, 2018 Del. Ch. LEXIS 325, at *193.

A. *Factual Background*

The court's 246-page opinion incorporates extensive factual findings.[100] This Section will address those findings in three parts: (1) the parties' pre-signing conduct, (2) the terms of the agreement, and (3) subsequent events leading up to Fresenius' MAE declaration.

1. Pre-Signing Conduct

This case involved a failed pharmaceutical merger between buyer Fresenius Kabi AG (Fresenius) and seller Akorn, Inc. (Akorn).[101] Akorn approached Fresenius in late 2016 to propose a merger.[102] The parties entered into two confidentiality agreements in November 2016 under which Fresenius conducted due diligence.[103] Fresenius made its initial bid shortly thereafter; Akorn turned down that bid and stated that Fresenius could not conduct full due diligence unless the company improved its bid.[104] Following an improved bid in February 2017, Fresenius gained access to Akorn's data room and conducted extensive due diligence regarding Akorn's regulatory compliance records.[105] Based on that investigation, the Fresenius board approved an additional bid increase after receiving a management presentation that identified risk factors such as product launch delays and necessary capital expenditures; this presentation, however, identified no data integrity risks.[106]

2. Applicable Bring-Down Conditions

The parties executed the final merger agreement on April 24, 2017.[107] That agreement defined an MAE in the traditional—though convoluted—terms as

> any effect, change, event or occurrence that, individually or in the aggregate (i) would prevent or materially delay, interfere with, impair or hinder the consummation of the [Merger] or the compliance by [Akorn] with its obligations under this

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[100] *See id.* To prevent exceeding the opinion's length, this Comment discusses only those facts relevant to the failed bring-down conditions.

[101] *Id.* at *6–7. Fresenius, a German corporation, and Akorn, a Louisiana corporation, chose Delaware law to govern the merger agreement. *Id.* at *15 n.14.

[102] *Id.* at *34–35.

[103] *Id.* at *36.

[104] *Id.* at *37–38. The first confidentiality agreement addressed due diligence generally. *Id.* at 36. The second confidentiality agreement granted access to competitive information with possible antitrust implications. *Id.*

[105] *Akorn*, 2018 Del. Ch. LEXIS 325, at *40.

[106] *Id.* at *42–43.

[107] *Id.* at *43.

> Agreement or (ii) has a material adverse effect on the business, results of operations or financial condition of the Company and its Subsidiaries, taken as a whole . . . .[108]

In the agreement's bring-down conditions, Akorn represented that (i) it complied with all applicable FDA regulations; (ii) it complied with all contemporary good manufacturing practices; (iii) its tests and studies had all been conducted within that compliance status; (iv) it had made neither fraudulent statements nor false or misleading statements of material fact to the FDA; and (v) all drug proposals previously submitted for FDA approval had been accurate, complete, and correct.[109] As is customary, Akorn warranted that each of those representations would remain true and correct through closing.[110] Any deviation from Akorn's as-represented conditions granted Fresenius the right to terminate the merger agreement if that deviation would reasonably be expected to constitute an MAE.[111]

3. Post-Signing Conduct

Between October 2017 and January 2018, while awaiting antitrust approval, Fresenius received three whistleblower letters concerning Akorn's compliance with FDA data integrity regulations.[112] When Fresenius investigated those concerns, it learned that (i) the data integrity systems used in Akorn's manufacturing process deviated significantly from FDA standards;[113] (ii) Akorn's data integrity systems contained numerous fundamental flaws that jeopardized its FDA compliance;[114] (iii) these flaws permitted Akorn employees to enter noncompliant tests and studies;[115] and (iv) prior drug proposals submitted for FDA approval had contained false, incomplete, and incorrect data sets.[116] Fresenius also forwarded the whistleblower letters to authorities.[117] When Akorn met with the FDA in March 2018 to address the letters, company representatives made statements that Fresenius later alleged to have been misleading or knowingly false.[118]

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108 *Id.* at *115 (first alteration in original).
109 *Id.* at *44.
110 *Id.*
111 *Akorn*, 2018 Del. Ch. LEXIS 325, at *45.
112 *Id.* at *63, *71.
113 *Id.* at *153.
114 *Id.*
115 *Id.* at *159–60.
116 *Id.* at *156–57.
117 *See Akorn*, 2018 Del. Ch. LEXIS 325, at *78.
118 *Id.* at *87. On receiving a copy of the meeting minutes, Fresenius's deal counsel sent a strongly worded letter accusing Akorn of making "false, incomplete and

At a board meeting on April 17, 2018, Fresenius learned that the costs of remediating FDA noncompliance devalued Akorn's equity by an estimated 37%.[119] In response, Fresenius asserted that Akorn was in breach of its warranties and extended an opportunity for Akorn to respond or otherwise refute the claim;[120] Akorn declined that offer.[121] Thereafter, Fresenius notified Akorn on April 22, 2018, that Fresenius was terminating the merger because, among other things, the failed bring-down conditions were reasonably likely to cause an MAE.[122] Akorn immediately filed suit, alleging that Fresenius wrongfully terminated the merger agreement.[123]

B. *Holdings*

The court analyzed whether the "deviation between Akorn's as-represented condition and its actual condition was so great that it would reasonably be expected to result in a[n] [MAE]."[124] Applying *Frontier Oil*, the court looked objectively at whether there was some basis in law and fact for Fresenius's assertion.[125] This Section considers how the court addressed (1) qualitative factors and (2) quantitative factors in reaching its conclusion.

1. Qualitative Factors

Beginning with the qualitative factors, the court concluded that overwhelming evidence supported Fresenius's MAE assertion.[126] Data integrity violations concerning essential aspects of Akorn's business existed in its systems at the time that Akorn made its representations.[127] Following the merger agreement, Akorn made no effort to remedy these failures, which increased in frequency and severity.[128] That increase could be traced back to employee misconduct, including falsified FDA

misleading" statements to the FDA, thereby violating the fifth warranty condition. *Id.* at *88.

[119] *Id.* at *89–90.

[120] *Id.* at *90–91.

[121] *Id.* at *91.

[122] *Id.*

[123] *Akorn*, 2018 Del. Ch. LEXIS 325, at *7.

[124] *Id.* at *7. Following *Hexion*, Fresenius bore the burden of proving that Akorn's failed bring-down conditions would be reasonably likely to cause an MAE. *Id.* at *145. The court first ruled that Fresenius had proven deviations from the as-represented condition. *Id.* at *7.

[125] *Id.* at *151.

[126] *Id.*

[127] *Id.* at *153.

[128] *Id.* at *152, *154.

submissions and management oversight neglect.[129] Fresenius supported these assertions with credible expert testimony, which the court accepted as suggesting a qualitative MAE from Akorn's failed bring-down condition.[130]

The court also weighed Akorn's dramatic shift in claimed regulatory compliance.[131] In May 2018, the FDA began an investigation into Akorn's facilities to evaluate the nature and severity of the whistleblower accusations.[132] During the late-stage FDA investigation, someone at Akorn erased a product-specific electronic database, together with its local backup file and related security logs, ostensibly to conceal further damaging data from the FDA.[133] Because Akorn's products required consistent, accurate, and reliable data, the court found that these systemic failures called into question the reliability of all company data; those questions meant that Akorn could not operate at all until it remedied the data integrity issues.[134] The court concluded that this necessary suspension in operations, brought about by "a disastrous culture of noncompliance[,]" constituted an essential failure of Akorn's MAE bring-down condition.[135]

2. Quantitative Factors

Turning to the quantitative elements, the court weighed the projected remediation costs and the resulting impact on deal value, and whether that impact would have been considered material by the parties at contract execution.[136] The parties' respective experts presented starkly conflicting projections as to remediation costs,[137] but the court rejected both estimates, determining that the actual remediation cost probably fell somewhere between those figures.[138] Taken alongside the deal price, the court's accepted remediation costs

129 *Akorn*, 2018 Del. Ch. LEXIS 325, at *155–57.
130 *Id.* at *159–61.
131 *See id.* at *165.
132 *Id.* at *94–95.
133 *Id.* at *164–65.
134 *See id.* at *165.
135 *Akorn*, 2018 Del. Ch. LEXIS 325, at *165–66.
136 *Id.* at *165–66.
137 *Id.* at *166. Fresenius anticipated that the regulatory violations were significantly more severe than had been detected in due diligence and, therefore, projected a remediation cost which represented the worst-case scenario. *Id.* at *168–71. By contrast, Akorn's expert predicted that no further compliance issues would be detected on subsequent audits and estimated remediation expenses for only those violations identified during due diligence. *Id.* at *166–68.
138 *Id.* at *172.

devalued the transaction by 21% of Akorn's total equity value.[139] Problematically, the record contained no evidence concerning the parties' subjective expectations or industry standards to indicate whether a 20% decrease in equity value would be material.[140]

Relying on his intuition, the Vice Chancellor ultimately determined that a 20% decrease in overall value met the quantitative materiality threshold.[141] In cross-checking this intuition, the Vice Chancellor considered four indicators suggesting that a 20% loss in total value would be considered material to a reasonable acquiror.[142] First, a 20% drop in stock prices creates a bear market.[143] Second, in renegotiations, after one party declares an MAE, the average buyer demands a 15% reduction from the original deal price.[144] Third, in stock consideration deals, parties generally set upper and lower collar bounds between 10% and 20%.[145] Finally, reverse termination fees[146] average at about 6% of the total transaction value.[147] For those reasons, the court found that the quantitative factors supported Fresenius's MAE assertions and,

139 *Id.*

140 *Id.* at *172–73.

141 *Akorn*, 2018 Del. Ch. LEXIS 325, at *173.

142 *Id.* at *174.

143 *Id*. That the public recognizes a term for that specific threshold, the court reasoned, indicates a broad cultural acceptance that this decrease is material. *Id.* at *175.

144 *Id.* at *175. This average price reduction suggested that a 20% decrease in the target company's total equity value would be material to a reasonable buyer. *Id.*

145 *Id.* at *175–76. The court found that even those these numbers represent a noisy proxy, which is usually accompanied by an additional MAE clause, the fact that parties generally renegotiate after a 10% loss indicates that parties would find a 20% loss material. *Id.* at *177. For a discussion of collars as a renegotiation tactic, see Micah S. Officer, *Collars and Renegotiation in Mergers and Acquisitions*, 59 J. FIN. 2719 (Dec. 2004).

146 Reverse termination fees, another buyer protection term commonly included in merger agreements, become payable by the buyer to the seller following a merger agreement termination caused by specific triggering events such as regulatory/antitrust approval, financing contingencies, and representation and warranty conditions. Bryan JM Quinn, *Optionality in Merger Agreements*, 35 DEL. J. CORP. L. 789, 809, 812 (2010). For a comparison study between reverse termination fees and MAE clauses, see Gilson & Schwartz, *supra* note 4.

147 *Akorn*, 2018 Del. Ch. LEXIS 325, at *177–78 (citing Matthew D. Cain et al., *Broken Promises: The Role of Reputation in Private Equity Contracting*, 40 J. CORP. L. 565, 593–94 (2015)). Noting that reverse termination fees mark another noisy proxy and that reverse termination fees essentially establish an option, the court nonetheless found that a 20% loss in value, which far exceeds the average 6% reverse termination fee, would likely be material to a reasonable buyer. *Id.*

together with the qualitative factors, excused Fresenius's closing obligations.[148]

C. *Appeal*

Chief Justice Strine, writing for a unanimous Delaware Supreme Court, affirmed the lower court in a three-page opinion.[149] Commending the Court of Chancery for its extensive fact findings and well-supported conclusions, the Supreme Court found "no need . . . to comment upon or to address [that] reasoning"[150] and accepted that Akorn had suffered an MAE so severe that Fresenius no longer bore its closing obligations.[151]

IV. THE POST-*AKORN* DELAWARE MAE STANDARD

This Part considers the complications that *Akorn* may impose on Delaware MAE jurisprudence, namely (A) the qualitative and quantitative thresholds applied, (B) changes to the drafting process caused by the framework provided, and (C) the shifting interpretation bias.

A. *Qualitative and Quantitative Thresholds*

Akorn's percentage quasi-threshold[152] for quantitative significance marks the only numeric data point at which Delaware courts have found an MAE, but the opinion's analysis of non-numeric qualitative factors affords significantly less guidance. Given the formulaic standard,[153] it is not hard to imagine how the *Akorn* standard might fall too far from the tree.

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[148] *Id.* at *166, *178. The court posited in a footnote that the findings were case-specific and that the percentages should not be interpreted as a bright-line rule. *Id.* at *173 n.740.

[149] Akorn, Inc. v. Fresenius Kabi AG, 198 A.3d 724 (Del. 2018) (en banc).

[150] *Id.* at 724 n.5. Notably, Chief Justice Strine decided *IBP* and implemented the seller-friendly policy perspective while sitting as a Vice Chancellor. *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14, 68 (Del. Ch. 2001).

[151] *Akorn*, 198 A.3d 724, 724 n.5 (Del. 2018) (en banc).

[152] Richard W. Slack & Joshua M. Glasser, *The Material Adverse Effect Landscape after* Akorn v. Fresenius, 15 PRATT'S J. OF BANKR. L. 29, 39 (Jan. 2019).

[153] *See* KLING & NUGENT, *supra* note 8, at § 11.09 ("[T]he *Akorn* opinion provides a clear methodology for evaluating the magnitude of a given effect and an approach for assessing its durational significance.").

1. The Quantitative Quasi-Bright-Line Rule

The decision's reliance on a 40% materiality benchmark supports the assertion that any decline exceeding that level will be deemed material;[154] this approach has since found support in subsequent decisions.[155] Moreover, notwithstanding the opinion's footnote admonishment,[156] it is likely that parties will now evaluate MAE claims against the decision's percentage benchmark because Akorn's 20% decrease in equity value represents the only data point in Delaware MAE jurisprudence.[157] Such reliance may well prove problematic because, as the opinion acknowledges,[158] each of the four justifications for that threshold oversimplifies materiality.

The decision first justifies the 20% materiality threshold by comparison with how the public perceives bear markets.[159] Of the four comparisons considered in the decision, this corollary comes closest to reflecting the party intent analysis emphasized in other decisions. Applying broad cultural understanding, however, clashes with the inherently fact-specific nature of an MAE. Moreover, this analogy does not account for the positional differences between strategic buyers and short-term investors.[160] A one-quarter earnings decline—like one that may occur during a bear market—might well be material to a short-term investor;[161] that same one-quarter earnings decline is less likely to be material to a strategic buyer seeking long-term earnings potential.[162] Because the bear market analogy groups those two types of buyers

[154] *Id.* ("[M]ost cases that have considered decreases in profits in the 40% or higher range found a [MAE] to have occurred.").

[155] Channel Medsystems, Inc. v. Boston Sci. Corp., No. 2018-0673-AGB, 2019 Del. Ch. LEXIS 1394, at *86 (Del. Ch. Dec. 18, 2019).

[156] Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325, at *173 n.740 (Del. Ch. Oct. 1, 2018), *aff'd en banc*, 198 A.3d 724 (Del. 2018).

[157] Slack & Glasser, *supra* note 152, at 39 ("Future cases will likely test whether an over-20% valuation hit automatically counts as qualitatively significant . . . ."); *see* Adam O. Emmerich & Trevor S. Norwitz, *The MAC Is Back: Material Adverse Change Provisions after* Akorn, THE INT'L COMP. LEGAL GUIDE TO: MERGERS & ACQUISITIONS (2019), at 5 ("A 20% decrease in the value of the seller may constitute a MAC.").

[158] *Akorn*, 2018 Del. Ch. LEXIS 325, at *178 ("I do not pretend that any of these indicators is directly on point.").

[159] *Id.* at *174.

[160] *See In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14, 67–68 (Del. Ch. 2001) (distinguishing what would be material to a strategic buyer from what would be material to a speculative investor).

[161] *Id.* at 67.

[162] *Id.*

together, it deviates from the well-established nuance underlying MAE declarations.[163]

Other data points provided in the opinion adhere more closely to the accepted materiality principles but may ultimately set the threshold even lower than 20%. Where a decline in equity value reaches only 15%, for example, the buyer may now argue that this drop represents what the parties might have agreed upon in subsequent renegotiations. And in stock-for-stock deals, parties who do not bargain for collars may nonetheless invoke the decision's materiality justification for a 10% decline in value—which would typically trigger a significant price change[164]—to demonstrate why a similar decline constitutes an MAE. The discussion of reverse termination fees provides an even lower data point, reasoning that a decline in value of more than 6% would cause the buyer to consider paying the reverse termination fee to avoid more significant long-term losses.[165] These data points suggest, troublingly, that a particular numeric value may apply even where parties fail to set a deal-specific threshold.

At least one subsequent opinion has reinforced that there is no sanctioned bright-line rule for what constitutes a quantitative MAE.[166] That opinion, however, also weighed the facts presented against the 20% materiality benchmark used in *Akorn*.[167] This treatment suggests that, given credible supporting evidence, Delaware courts may be willing to follow the *Akorn* materiality benchmark.[168] But it remains to be seen whether the 20% threshold will create false positives[169]—or

163 Subsequent opinions have further consolidated those positions into a "reasonable investor/acquiror" label. *See* Channel Medsystems, Inc. v. Boston Sci. Corp., No. 2018-0673-AGB, 2019 Del. Ch. LEXIS 1394, at *54 (Del. Ch. Dec. 18, 2019).

164 *Akorn*, 2018 Del. Ch. LEXIS 325, at *175–76.

165 *Id.* at *177–78.

166 *Channel*, 2019 Del. Ch. LEXIS 1394, at *86.

167 *Id.*

168 *See* Glenn West et al., *Just Because a Really Bad Thing Happens Does Not Mean a Material Adverse Effect Has Occurred: Assessing the Latest Delaware MAE Decision*, WEIL, GOTSHAL & MANGES LLP (Dec. 24, 2019) https://www.weil.com/~/media/mailings/2019/q1/channel-medsystems_clean-revision-4.pdf ("The Chancellor's highlighting of these benchmarks suggests that parties . . . consider whether they can demonstrate a decline of *at least* 20% before asserting [an] MAE.") (emphasis in original).

169 *See* Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 889 (2010) (defining false positives as "circumstances in which the proxy condition is violated, but the parties would not intend to excuse the buyer").

false negatives[170]—where parties assert that a decrease in equity value is sufficiently material.[171]

2. The Qualitative Threshold

An additional complication to the quasi-threshold is that the MAE test for failed bring-down conditions balances quantitative factors against qualitative factors.[172] While the *Akorn* decision provides significant guidance toward quantification,[173] the qualitative materiality analysis affords much less clarity.

The qualitative analysis may turn on whether the buyer has presented overwhelming evidence showing an essential failure in the target business.[174] Qualifying the failure as essential suggests that, absent evidence meeting the numeric thresholds, the target business must have sustained such extreme damage that the transaction's principal purpose has been irreparably frustrated.[175] An essential failure standard would, therefore, expand upon the common law doctrine of frustration of purpose.[176] Alternatively, the qualitative test may examine the context to determine whether the purposes of the contract have been, or are reasonably likely to be, materially impaired. Systemic effects that would likely continue, worsen, or spread across the target business might certainly impair a company such that the transaction is materially frustrated. In that sense, qualitative considerations seemingly include primary as well as secondary purposes, and whether those purposes will collide because of the adverse effect.[177] Until future decisions shed light on the qualitative treatment applied in *Akorn*, this element remains an unclear aspect of the MAE framework.

[170] *See id.* (defining false negatives as "circumstances in which the condition is not violated, but the parties would want to excuse the buyer in order to achieve the contracting goals of efficient investment or signaling").

[171] *See* Slack & Glasser, *supra* note 152, at 39; West et al., *supra* note 168, at 2.

[172] Akorn, Inc. v. Fresenius Kabi AG, 2018 Del. Ch. LEXIS 325, at *150–51 (Del. Ch. Oct. 1, 2018) (quoting Frontier Oil Corp. v. Holly Corp., 2005 Del. Ch. LEXIS 57, at *36 n.224 (Del. Ch. Apr. 29, 2005)), *aff'd en banc*, 198 A.3d 724 (Del. 2018).

[173] *See* KLING & NUGENT, *supra* note 8, at § 11.09.

[174] *Akorn*, 2018 Del. Ch. LEXIS 325, at *151–52.

[175] *See* Genesco, Inc. v. Finish Line, No. 07-2137-II(III), 2007 Tenn. Ch. LEXIS 1, at *53–55 (Tenn. Ch. Dec. 27, 2007); Pine State Creamery Co. v. Land-O-Sun Dairies, Inc., No. 98-2441, 1999 U.S. App. LEXIS 31529, at *16 (4th Cir. Dec. 2, 1999) (per curiam); *see also* Schwartz, *supra* note 10, at 830–31.

[176] *See* Schwartz, *supra* note 10, at 830–31.

[177] *See Genesco*, 2007 Tenn. Ch. LEXIS 1, at *16–19 (contextualizing primary and secondary failures to find an MAE).

B. *Drafting Changes*

Combination agreements require extensive artisanal drafting to reflect the unique facts and circumstances surrounding each transaction.[178] That significant customization leaves many agreement terms, including bring-down conditions, open for negotiation.[179] Moreover, the high stakes place MAE conditions among the most heavily negotiated merger terms.[180] Targets prefer narrow language with fewer exceptions to the buyer's closing obligations,[181] whereas buyers prefer broad language, which affords more flexibility to walk away.[182] Because parties can rarely agree to precise terms, merger agreements typically include vague language and do not define what would be considered material to the transaction.[183] This drafting technique limits the risk of potentially overbroad or underinclusive language.[184] Deliberately vague terms also reduce drafting costs which would otherwise be incurred by attempting to foresee all possible scenarios.[185] But intentional ambiguity effectively delegates interpretation to courts should the transaction go south.[186] The associated juridical risk[187] can dilute these strategic decisions because MAE interpretations notoriously defy consistency.[188]

178 Robert Anderson & Jeffrey Manns, *Boiling Down Boilerplate in M&A Agreements: A Response to Choi, Gulati & Scott*, 67 DUKE L.J. ONLINE 219, 226 (Jan. 2019) (finding that "over half of the text of merger agreements is routinely rewritten from one deal to the next").

179 Brooks, *supra* note 56, at 86.

180 Choi & Triantis, *supra* note 169, at 853; Miller, *supra* note 4, at 2012.

181 Schwartz, *supra* note 10, at 822.

182 *Id.*

183 Choi & Triantis, *supra* note 169, at 883; *see* Symposium, *Negotiating Acquisitions of Public Companies*, *supra* note 32, at 243 (comment of Joel Greenberg) (describing how overly specific terms might "totally put the nail in the coffin for any event [the parties] didn't list").

184 Inclusivity is particularly problematic in M&A transactions, where information asymmetry often becomes apparent only after due diligence. Choi & Triantis, *supra* note 169, at 855.

185 John F. Coyle & W. Mark C. Weidemaier, *Interpreting Contracts Without Context*, 67 AM. U. L. REV. 1673, 1677 (2018); *see* Gilson & Schwartz, *supra* note 4, at 357 ("[I]t would be too costly for parties to create behavioral codes that courts could merely enforce."). *But see* Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 205–06 (2009) (arguing that ambiguous contract language does not reduce drafting costs but seeks to prevent either side from misinterpreting the terms).

186 David Cheng, *Interpretation of Material Adverse Change Clauses in an Adverse Economy*, 2009 COLUM. BUS. L. REV. 564, 574 (2009).

187 Juridical risk is the possibility that specific clauses or terms may be inappropriately included or excluded in the course of litigation. Gilson & Schwartz, *supra* note 4, at 354.

188 *Id.*; *see also* Choi & Triantis, *supra* note 169, at 854.

By expressly rejecting the frustration of purpose approach to MAE interpretation,[189] the *Akorn* opinion confirmed that MAE clauses do have an independent meaning after all.[190] Problematically, that meaning may not be what parties subjectively intended. The juridical risk created by *Akorn* will promote narrow drafting language as parties attempt to contract around common law materiality thresholds.[191] By carving out narrow exceptions, parties can address known risks and clearly articulate specific intent.[192] But interpreting narrow drafting necessarily assumes that even where risks are unforeseen—or undisclosed—the parties have some specific intent to articulate.[193] At the time of contract execution, parties might not have a specific, subjective intent regarding whether a particular event or circumstance would or would not be material.[194] In those scenarios, tightly drafted language designed to reflect the parties' clear understanding can trigger false positives or false negatives—which would precisely contradict subjective intent.[195]

[189] Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325, at *132 (Del. Ch. Oct. 1, 2018) (quoting Schwartz, *supra* note 10, at 807) ("'In lieu of the default rule that performance may be excused only where a contract's principal purpose is completely or nearly completely frustrated, a contract could lower this bar to an achievable level by providing for excuse when the value of counter-performance has "materially" . . . diminished.' That is what the parties did in this case."), *aff'd en banc*, 198 A.3d 724 (Del. 2018).

[190] *See* Emmerich & Norwitz, *supra* note 157, at 8.

[191] West et al., *supra* note 168, at 2; *see* Leslie J. Levinson & Anna Jinhua Wang, *The* Akorn *Case – New Development in Delaware for Termination by Material Adverse Effect*, THE NAT'L L. REV., Feb. 6, 2019, https://www.natlawreview.com/article/akorn-case-new-development-delaware-termination-material-adverse-effect ("From a drafting perspective, if a particular MAE the contracting parties contemplate could be quantified, the parties should consider setting a specific metric to the definition of such MAE.").

[192] Levinson & Wang, *supra* note 191. For specific scenarios where a known condition threatens the deal's vitality before contract execution, buyers may prefer narrow language that predetermines the impact that the condition will have on each party. During the 2020 global coronavirus disease pandemic, for example, some public company merger agreements explicitly addressed the parties' respective performance expectations. *See, e.g.*, Grace Maral Burnett et al., *Analysis: Morgan Stanley, E*Trade Merger Excludes Coronavirus*, BLOOMBERG, Feb. 28, 2020, https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-morgan-stanley-e-trade-merger-excludes-coronavirus (highlighting language which excludes any "epidemic, pandemic or disease outbreak (including the COVID-19 virus)" from qualifying as an MAE).

[193] *See* Brooks, *supra* note 56, at 101.

[194] Hill, *supra* note 185, at 216.

[195] *See* Brooks, *supra* note 56, at 101.

Interpretation risk further increases given the inherently fact-specific nature of MAE circumstances, where predetermined criteria often prove arbitrary.[196] Requiring parties to anticipate and address every possible deal risk would impracticably complicate the negotiation and drafting process.[197] Moreover, because specific language necessarily excludes broad meaning,[198] narrow terms limit extracontractual evidence, which could otherwise illuminate how the parties would have addressed the eventual circumstances.

C. *Interpretation Bias*

Akorn sets a heavy burden for sellers, who must now make a strong showing following a 20% projected loss.[199] Where the anticipated decline in equity value exceeds 20%, sellers will need to bring strong evidence showing subjective expectations under the agreement and why those expectations are not consistent with finding the current loss material.[200] Even where the anticipated loss does not meet the 20% quasi-presumption, sellers will have to analogize away from renegotiation price adjustment rates, collars, and reverse termination fees, each of which sets a lower data point than the 20% decline found in the *Akorn* opinion.[201]

And for all that *Akorn* giveth, it taketh very little away. Despite any contrary appearances, Delaware courts did not expressly swear off the *IBP* seller-friendly policy perspective. Until further opinions address that issue, it is difficult to determine whether the *Akorn* deviation will remain confined to the facts presented.[202] Further, the decision did not

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196 *See* Michelle Shenker Garrett, *Efficiency and Certainty in Uncertain Times: The Material Adverse Change Clause Revisited,* 43 COLUM. J.L. & SOC. PROBLEMS 333, 359 (Spring 2010).

197 *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14, 144 (Del. Ch. 2001) (positing that narrow judicial interpretation would "encourage the negotiation of extremely detailed 'MAC' clauses with numerous carve-outs or qualifiers").

198 *See* Schwartz, *supra* note 10, at 829.

199 West et al., *supra* note 168, at 2.

200 Slack & Glasser, *supra* note 152, at 39 (suggesting that sellers projecting a valuation loss greater than 20% "will have to explain why they believe that [*Akorn*]'s quasi-bright-line . . . is off").

201 *See id.*

202 The COVID-19 pandemic triggered a flood of MAE litigation that asked Delaware courts to decide whether the pandemic constituted an MAE. For a consolidated list of such cases, see CHANCERY BLOG, *Delaware Corporate Litigation in the Time of Coronavirus*, http://chanceryblog.com/court-procedure/ (last visited June 17, 2020). As of the date of this Comment, Delaware courts have not decided this issue but seem to acknowledge that the circumstances may qualify. For example, in a telephonic hearing for one COVID-19 MAE case, the Chancery Court withheld a ruling due to "the sheer breadth and complexity of the legal issues" necessarily raised by MAE claims. Telephonic Rulings of

negate the heavy burden faced by buyers who seek to avoid performance by invoking an MAE. By deviating from the *IBP* "backstop" approach,[203] however, *Akorn* creates an opportunity to revisit the Delaware MAE approach.

V. RECOMMENDATIONS FOR AN UPDATED MAE STANDARD

Delaware courts should adopt a new MAE standard by (A) clarifying the qualitative analysis set by the *Akorn* opinion and (B) eliminating presumptive advantages. This Part argues that courts should avoid restating common law default rules and adopt a three-part conduct/intent standard, as well as an unbiased interpretation policy, to reflect bargained-for contractual rights.

A. *Clarify the Qualitative Analysis*

When applying *Akorn*, Delaware courts should specify a standard of qualitative review for when a failed bring-down condition constitutes an MAE. This Section considers two conflicting standards: (1) an essential failure standard and (2) a conduct/intent standard.

1. The Essential Failure Standard

Discussing how Akorn's data integrity violations represented an essential failure to its business operations, and how overwhelming evidence supported Fresenius's claim, raises a useful starting point for a new qualitative MAE test. Delaware courts could use a context-specific approach that analyzes all relevant circumstances to determine what constitutes an essential failure. And in defining overwhelming evidence, Delaware courts could specify the heavy burden framework outlined in prior decisions as one which requires objective and subjective proof that the essential failure is reasonably likely to result in an MAE.[204] That high evidentiary standard could help to weed out claims motivated by buyer's remorse. And while long-term goals would remain the paramount indication of party intent, the buyer could demonstrate how the failed bring-down condition had been essential to a short-term goal or secondary purpose sought through the transaction.

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the Court on Plaintiff's Motion to Expedite at 15–22, Juweel Inv'rs Ltd. v. Carlyle Roundtrip, L.P., C.A. No. 2020-0338-JRS (Del. Ch. May 20, 2020). As of the date of this Comment, Delaware courts have yet to posit whether the COVID-19 pandemic may circumstantially constitute an MAE. *See* Verified Complaint at 4, Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE, et al., C.A. No. 2020-0768-JRS (Del. Ch. Sept. 9, 2020).

[203] *See* Slack & Glasser, *supra* note 152, at 9.

[204] For a similar MAE approach, see Genesco, Inc. v. Finish Line, No. 07-2137-II(III), 2007 Tenn. Ch. LEXIS 1 (Tenn. Ch. Dec. 27, 2007).

The dilemma with an essential failure MAE standard is that it effectively restates the "basic assumption" standard set forth in common law default rules.[205] As the *Akorn* opinion points out, "[i]t is not reasonable to conclude that sophisticated parties to merger agreements, who expend considerable resources drafting and negotiating [MAE] clauses, intend them to do nothing more than restate the default rule."[206] If parties intend to excuse performance only on the occurrence of an essential failure, those parties could invoke impracticability[207] or frustration of purpose[208] rather than relying on a contractual provision. Moreover, the burden of producing overwhelming evidence to support an MAE assertion would turn the buyer's already heavy burden into a Sisyphean undertaking, virtually negating bargaining power for MAE terms. Where parties meticulously negotiate an MAE clause, applying a common law default rule fills a nonexistent gap in contravention to established contract law.[209]

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205 *See* RESTATEMENT (SECOND) OF CONTRACTS § 261 (AM. LAW INST. 1981) ("Where . . . a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a *basic assumption* on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.") (emphasis added); RESTATEMENT (SECOND) OF CONTRACTS § 265 (AM. LAW INST. 1981) ("Where . . . a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a *basic assumption* on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.") (emphasis added); RESTATEMENT (SECOND) OF CONTRACTS § 266(2) (AM. LAW INST. 1981) ("Where, at the time a contract is made, a party's principal purpose is substantially frustrated without his fault by a fact of which he has no reason to know and the non-existence of which is a *basic assumption* on which the contract is made, no duty of that party to render performance arises . . . .") (emphasis added).

206 Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325, at *132 (Del. Ch. Oct. 1, 2018) (quoting Schwartz, *supra* note 10, at 828), *aff'd en banc*, 198 A.3d 724 (Del. 2018).

207 *See* RESTATEMENT (SECOND) OF CONTRACTS § 261 (AM. LAW INST. 1981).

208 *See* RESTATEMENT (SECOND) OF CONTRACTS § 265 (AM. LAW INST. 1981).

209 *See* 3M Co. v. Neology, Inc., No.: N18C-07-089 AML CCLD, 2019 Del. Super. LEXIS 312, at *29–30 (Del. Ch. June 28, 2019) (rejecting allegations of breach of the implied covenant of good faith and fair dealing where the MAE clause addressed the conflict at issue); *cf.* Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 6 (2007) ("Barring any evidence to the contrary, courts should restrain themselves from reaching any conclusions other than those that the parties, who are perceived to have understood the terms of the written agreement and bargained for and negotiated the relationship created by the contract in exchange for consideration."). *But cf.* Dunlap v. State Farm Fire & Cas. Co., 878 A.2d 434, 442 (Del. 2005) (observing that Delaware courts have "recognized the occasional necessity of implying contract terms to ensure the parties' reasonable expectations are fulfilled") (internal quotation marks omitted).

Put differently, if parties intended to rely on common law default rules, merger agreements would not need MAE clauses at all. And as applied to bring-down conditions, an essential failure standard would comport almost identically with those rules. For example, inaccurate representations or warranties made by the seller that relate to the buyer's primary or secondary purposes for contracting, which inaccuracies exist at contract execution, could excuse the buyer's closing obligations under the common law doctrine of existing frustration.[210] Again, an approach that interprets MAE clauses as directly mimicking common law default rules defeats that clause's purpose and renders the language—and the parties' stringent negotiations—essentially superfluous.

2. The Conduct/Intent Standard

Rather than relying on common law default rules, a new approach can be extracted from the pattern seen across Delaware opinions that carefully scrutinizes party intent to determine whether the events in question constitute an MAE.[211] Under this approach, qualitative considerations would weigh the seller's conduct and disclosures against the buyer's conduct and intentions surrounding the MAE declaration. The conduct/intent approach would yield a new three-step test for whether qualitative elements suggest an MAE.

This analysis would first consider the specific language chosen by the parties to denote an MAE bring-down condition together with the context of the agreement. Where parties disagree as to materiality qualifiers or carveout language, the court should view the terms in the context of the language finalized elsewhere in the parties' agreement.[212]

[210] *See* RESTATEMENT (SECOND) OF CONTRACTS § 266(2) (AM. LAW INST. 1981). The ability to consider foreseeable events does not negate this comparison because foreseeability relates only to post-signing developments. For inaccuracies existing at the time of contract execution, a separate standard is necessary because "one cannot go back in time to fix a representation made as of a date in the past" and thus negate the buyer's MAE declaration. *See* Channel Medsystems, Inc. v. Boston Sci. Corp., No. 2018-0673-AGB, 2019 Del. Ch. LEXIS 1394, at *70 (Del. Ch. Dec. 18, 2019).

[211] *See Akorn*, 2018 Del. Ch. LEXIS 325, at *152–66 (analyzing buyer's conduct throughout the transaction); Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 722 (Del. Ch. 2008) (viewing buyer's conduct negatively where such conduct deviated from the parties' professed intent); Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 Del. Ch. LEXIS 57, at *109–19 (Del. Ch. Apr. 29, 2005) (considering conduct by both parties which contributed to deal failure); *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, 789 A.2d 14 (Del. Ch. 2001) (suggesting throughout that the court did not believe, due to Tyson's conduct, that Tyson believed IBP had sustained an MAE).

[212] *Hexion*, 965 A.2d at 741 ("It is a maxim of contract law that, given ambiguity between potentially conflicting terms, a contract should be read so as not to render any term meaningless.").

Next, the court would inquire as to whether the seller materially deviated from its represented or warranted condition.[213] Expert opinions, and the credibility underlying such reports, would receive close scrutiny to ensure that the materiality finding reflects the seller's accurate financial and operational status.[214] And because the *Akorn* analysis factored post-trial events into its findings, the actual outcome of the seller's deviations or omissions would likely factor into a materiality finding.[215] Finally, the court would analyze the objective reasonableness of the buyer's belief that the target company had sustained an MAE as well as subjective evidence supporting or undermining that belief.[216] Crucial to this analysis would be evidence showing the buyer's subjective beliefs throughout the transactional timeline, including the motivating factors for the MAE declaration and any surrounding circumstances which would detract from that assertion.[217]

The conduct/intent standard avoids the problematic application of common law default rules. The analysis ensures that, under the appropriate circumstances, buyers can benefit from their heavily negotiated MAE clauses. Simultaneously, this approach fends off buyer's remorse where the declarations appear pretextual or

[213] A material deviation from a representation or warranty "alter[s] the 'total mix' of information made available" to a reasonable buyer. *Channel*, 2019 Del. Ch. LEXIS 1394, at *42–43 (quoting *Akorn*, 2018 Del. Ch. LEXIS 325, at *86). This standard is analytically distinct from the "long-term earnings potential" standard applicable to MAE assertions. *Id.* at *43.

[214] This is not to suggest that expert reports are not already subjected to high scrutiny. Rather, expert reports can demonstrate whether the party submitting that report intended the opinion to accurately reflect the financial and operational conditions when the MAE was declared. *See Hexion*, 965 A.2d at 727 (holding insolvency opinion, prepared in anticipation of litigation, unreliable for actual valuation estimates). For a post-*Akorn* MAE opinion applying this approach, see *Channel*, 2019 Del. Ch. LEXIS 1394, at *86–94.

[215] *See Channel*, 2019 Del. Ch. LEXIS 1394, at *77–78 (finding buyer's MAE prediction unreasonable where the anticipated events did not occur).

[216] At least one post-*Akorn* decision has found no MAE where the buyer's belief was not objectively reasonable in light of the transactional circumstances. *Id.* at *85.

[217] This analysis is distinguishable from a common law implied covenant of good faith and fair dealing analysis. To invoke the implied covenant of good faith and fair dealing, a party must demonstrate a gap in the agreement's express terms. *See, e.g.*, Vintage Rodeo Parent v. Rent-A-Center, Inc., No. 2018-0927-SG, 2019 Del. Ch. LEXIS 87, at *62 (Del. Ch. Mar. 14, 2019) ("What the Plaintiffs ultimately seek is equitable fairness, which is not promised by the implied covenant."). Where a contractual provision defines an MAE and establishes specific conditions precedent, the implied covenant of good faith and fair dealing provides no additional deal protection. *See* 3M Co. v. Neology, Inc., No. N18C-07-089 AML CCLD, 2019 Del. Super. LEXIS 312, at *29–30 (Del. Ch. June 28, 2019). Rather, a conduct analysis mirrors the established inquiry as to the parties' conformity with contractual expectations. *See supra* text accompanying note 211.

inconsistent with party conduct. Determining materiality through conduct and intent, as well as plain contract language, returns the focus to what the parties understood the contract to mean. That focus should be prominent and primary throughout MAE interpretation because, as *IBP* reiterates, effectuating the parties' intentions is the objective of judicial review of private agreements.[218]

B. *Eliminate Presumptive Advantages*

A party-neutral standard that expands on *Akorn*'s qualitative analysis could avoid numeric presumptions and also prevent Delaware courts from massacring future MAE claims. Biased interpretation standards effectively rewrite contract language where parties set intentionally vague terms.[219] And granting either party an inherent advantage goes against the contractarian theory that Delaware courts stringently respect.[220]

The solution to MAE interpretation is not to evenly distribute interpretation bias, but to eliminate bias altogether. Rather than approaching MAE assertions as presumptively motivated by buyer's remorse, Delaware courts should recognize MAE claims for what they are: one party's assertion of a bargained-for contractual right.[221] Such recognition demands the abandonment of the seller-friendly policy. Simultaneously, future opinions should acknowledge that the numeric benchmark outlined in the *Akorn* opinion, while illustrative of what may constitute materiality, cannot itself be dispositive.[222] By moving away from the seller-friendly policy and expressly disclaiming the percentage thresholds, Delaware courts can move toward a genuinely contractarian MAE interpretation standard.

VI. CONCLUSION

The *Akorn* decision shows that Delaware courts are, in fact, capable of permitting a buyer to back out after a failed bring-down condition is proven likely to cause an MAE. Though not expressly abandoning the seller-friendly policy, this opinion serves as a helpful starting point for reevaluating how Delaware courts approach MAE claims. To better reflect the purpose of judicial review, future opinions should cautiously

218 *IBP*, 789 A.2d at 55.

219 *See* Hill, *supra* note 185, at 216.

220 *See* Brooks, *supra* note 56, at 101–02.

221 *See* Brooks, *supra* note 56, at 106–07.

222 *Cf.* Basic, Inc. v. Levinson, 485 U.S. 224, 236 (1988) ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over- or under-inclusive.").

apply *Akorn* to shift the Delaware MAE standard toward an approach which carefully considers whether, as evidenced through conduct and intent, the parties would reasonably have expected the development to constitute an MAE and waive the buyer's obligation to close. That conduct/intent approach would ensure that bring-down conditions, and failure to comply therewith, grant protection for buyers with justifiable remorse.