VI. Material Adverse Effect: A (Delaware) Case Law Overview

A. Introduction

Material Adverse Effect (MAE) is a contractual term and provision through which an acquiring company may, if successful in court, be freed "of their obligations under signed acquisition agreements."[1] These provisions are designed to apply to various types of acquisition agreements to protect the acquiror from scenarios where there is a negative, material, and adverse alteration in the target company or its outlook, in accordance with the contract-specific terms of the given MAE provision, "during the interim period between signing of the agreement and closing."[2] Furthermore, MAE provisions can be compared to ordinary course covenants, but the two types of provisions may be distinguished.[3] An ordinary course covenant, in its most generic sense, is a covenant that a seller or target company makes that they will not materially alter its business or operations during the time between signing the agreement and closing; an MAE provision "allocates the risk of changes in the target company's valuation."[4]

Importantly, while definitions vary contract-to-contract, material adverse effects are often defined in given MAE provisions to include occurrences or changes that alone, or collectively, materially adversely affects the seller or target company – though a given MAE provision is likely to be far more detailed than this generic example.[5] It is also noteworthy that MAE provisions generally include varying

---

[1] Nina L. Flax et al., *MAE – Still a Very High Bar Post-Akorn*, MAYER BROWN (July 20, 2021), https://www.mayerbrown.com/en/perspectives-events/publications/2021/07/mae-still-a-very-high-bar-post-akorn [https://perma.cc/BZ35-SFXK].

[2] Tucker DeVoe et al., *Acquirer Beware: "Material Adverse Effects" in Merger Contracts and How Shifting Reimbursement Rates Impact the Healthcare Sector*, JD SUPRA (Aug. 10, 2021), https://www.jdsupra.com/legalnews/acquirer-beware-material-adverse-9279486/ [https://perma.cc/N9VN-CLMW].

[3] AB Stable VIII LLC v. MAPS Hotel and Resorts One LLC, No.71, 2021 WL 5832875, at *13 (Del. Dec. 8, 2021) (describing different standards between ordinary course covenants and material adverse effect provisions).

[4] *Id*.

[5] Flax et al., *supra* note 1 ("In light of *Bardy v. Hill-Rom*, we expect that MAE clauses will continue to be heavily negotiated. In particular, we anticipate that dealmakers will focus on (1) whether to use broadly defined terms in the MAE definition.").

exceptions, called "carve-outs," that serve as defined instances in which the provision does not enable the acquiror to opt out of the agreement.[6] Moreover, MAE provisions often also include exceptions to their given enumerated carve-outs.[7] For example, one may describe that a carve-out will not apply unless the material adverse effect affected similar companies in the given industry.[8] Generally, the process by which an acquirer may succeed in a MAE case can be outlined as follows:

> [T]he burden of proof shifts between the parties—the purchaser bears the initial burden to prove by a preponderance of the evidence that the seller suffered an effect that was material and adverse; upon the purchaser satisfying that burden of proof, the burden shifts to the seller to prove by a preponderance of the evidence that the source of the effect fell within a carve-out to the definition of MAE set forth in the merger agreement; and, assuming the target is able to do so, the purchaser then has to prove by a preponderance of the evidence that the exclusion to the carve-outs applies.[9]

Having briefly described the purpose and structure of a generic MAE provision, this development article (this "Article") seeks to analyze case law, both older and recent, relevant to or advancing MAE doctrine – particularly dealing with COVID-19 pandemic's (Covid) effects on MAE and recent adjustments to how Delaware courts analyze material adverse effects, versus events, under MAE provisions. This Article will first articulate a general case history and the MAE standards developed thereunder. It will then address current conditions or regulations that affect MAE doctrine. Finally, this Article will discuss MAE trends, recent changes, and expected future developments.

B. Pertinent Case Law History

---

[6] *Id*. ("The MAE definition is a typical one for a heavily negotiated transaction with . . . (ii) carve-outs of certain types of events that would otherwise give rise to an MAE.").
[7] *Id*. ("The MAE definition is a typical one for a heavily negotiated transaction with … and (iii) exceptions to the carve-outs.").
[8] *Id*. ("… the wording of the disproportionate impact exception to any carve-outs (e.g., parties may try to define with specificity what is meant by 'similarly situated companies.'").
[9] *Id*.

Delaware courts have historically interpreted MAE provisions with incredibly high levels of scrutiny and, thus, have been unlikely to grant effect to a given MAE provision in almost any suit.[10] One of the seminal cases in MAE doctrine, *In re IBP, Inc. Shareholders Litigation*, set forth general rules for determining if a given MAE provision can serve as an opt out mechanism for a given acquirer.[11] The court in this case prefaces its general MAE standard by acknowledging that "[m]erger contracts are heavily negotiated and cover a large number of specific risks explicitly."[12] The opinion goes on to state that even when a MAE condition is broadly defined under its given MAE provision, "that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner."[13] This holding, from 2001, is significant because it acknowledges that the parties involved in an acquisition transaction have already weighed risks through a negotiation.[14] The court considers that the parties heavily discussed specific scenarios in which MAE would apply, and it suggests that the heavy negotiating limits the scenarios in which a MAE clause would be triggered.[15] This is likely a reason for why the standard for opting out through MAE in Delaware courts is so difficult to clear. The holding also further explains that "[a] short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror."[16]

Very few cases have held MAE to be the correct vehicle for acquiror opt outs; one such Delaware case is *Akorn*.[17] In this case, one

---

[10] *Id*. ("The ruling reaffirms the Delaware court's strong reluctance to find that events constitute an MAE, thereby absolving purchasers of their obligations under signed acquisition agreements.").

[11] *In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 68 (Del. Ch. 2001) ("As a result, even where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner.").

[12] *Id*.

[13] *Id*.

[14] *Id*. (discussing throughout that the risks were allocated to Tyson through the Schedules that came with the Parties' Agreement).

[15] *See id*. (discussing accepted risks that financial improprieties by acquired corporation's subsidiary may result in and accepted disclosed risks as well).

[16] *Id*.

[17] Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *101 (Del. Ch. Oct. 1, 2018) ("Fresenius validly terminated the

factor relevant to the court's determination was that the seller's Regulatory Compliance Representations were false, and the difference between its actual and represented conditions "would reasonably be expected to result in a Regulatory MAE."[18] Another relevant factor is that "[t]he sudden and sustained drop in [seller company's] business performance constituted a General MAE."[19] The court finds that requiring the buyer suffer a loss to constitute a MAE ignores the relative opportunity cost to the buyer.[20] It is also important to note that here, the buyer did not know "about the specific events that resulted in [seller company's] collapse."[21] The judge admits they found that the expense the seller incurred would be material in the long-term based on weighing "the evidence in the record against [their] own intuition and experience."[22] However, "[a]nalyst's estimates for [the seller's] 2018, 2019, and 2020 EBITDA were lower than those at the time of signing by 62.6%, 63.9%, and 66.9%, respectively."[23] Thus, the court held that "[t]he sudden and sustained drop in Akorn's business performance constituted a General MAE."[24] Thus, although not perfectly clear, this case does serve to illustrate many factors indicative of those that might trigger an acquiror's ability to opt out under a given MAE provision.

More recently, in 2021, Delaware courts found that requirements for a MAE provision were not met – after novel analysis – in *Bardy Diagnostics, Inc. v. Hill-Rom, Inc*.[25] The Delaware court held this "[d]espite acknowledging that the attempted Hill-Rom termination

---

Merger Agreement because Akorn's Regulatory Compliance Representations were untrue … [t]his scenario caused the Bring-Down Condition to fail in an incurable manner and entitled Fresenius to terminate.").

[18] *Id*. at *47.

[19] *Id*.

[20] *Id*. at *57 ("Requiring a loss before a buyer could show an MAE also would ignore the fact that acquirers evaluate rates of return when choosing among competing projects, including acquisitions.").

[21] *Id*. at *62.

[22] *Id*. at *74 ("Although both the factual record and the corpus of available authority are limited, I believe that for Akorn, this expense would be 'material when viewed from the longer-term perspective of a reasonable acquirer.").

[23] *Id*. at *56.

[24] *Id*.

[25] Bardy Diagnostics, Inc. v. Hill-Rom, Inc., No. 2021-0175-JRS, 2021 WL 2886188, at *42 (Del. Ch. July 9, 2021) ("Hillrom has failed to carry its burden to prove that it is excused from closing on the Merger by the occurrence of an MAE since it has failed to prove the April Novitas Rate will have a durationally significant material effect on Bardy.").

was not the typical case of 'buyer's remorse' and likening the hit that the rate reduction had [86%] to Bardy's prospective earnings as a 'Tyson right uppercut.'"[26] The court succinctly acknowledges the risk-apportionment purpose behind MAE provisions and their carve-outs, describing that a standard MAE provision places the risk of the company on the seller and, through carve-outs, certain market-at-large risks on the buyer.[27] Furthermore, as it did similarly in *Akorn*, the court notes that acquisition transactional agreements, negotiated between sophisticated parties, do not merit the court rewriting the contract.[28]

C. Current Conditions or Regulations That Affect MAE Doctrine

Although there is not a particular Covid-related regulatory rule or law in effect that affects MAE in negotiations between parties or in court proceedings, it has nevertheless affected the doctrine. Covid has had a negative impact on various industries, and has, foreseeably, caused companies within these given industries to adjust their operations in some manner.[29] This implicates MAE doctrine.

For example, in *AB Stable VIII LLC v. MAPS Hotel and Resorts One LLC*, Covid struck the hotel industry before the closing of an agreement where the acquirer agreed to purchase hotel property from the seller company, and the seller adjusted its hotel operations significantly in response to the pandemic.[30] Although the acquirer attempted to opt out of the agreement by means of the MAE provision, the court found that "the Ordinary Course Covenant imposed an overarching and absolute obligation, and that it did not incorporate a

---

[26] Flax et al., *supra* note 1.
[27] *Bardy*, 2021 WL 1714202, at *21 ("From a drafting perspective, the MAE provision accomplishes this by placing the general risk of an MAE on the seller, then using [carve-outs] to reallocate specific categories of risk to the buyers.").
[28] *Id*. at *23 ("Here, as in *Akorn*, the parties structured the MAE definition to incorporate carve-outs and exceptions to allocate risk… [t]hat construction, therefore, is rejected.").
[29] *See* AB Stable VIII LLC v. MAPS Hotel and Resorts One LLC, No.71, 2021 WL 5832875, at *1 (Del. Dec. 8, 2021) ("A closing delay brought an unexpected problem – the novel coronavirus COVID-19 and the damage it inflicted on the hospitality industry. In response to the pandemic, and without securing the Buyer's consent, the Seller made drastic changes to its hotel operations.").
[30] *Id*.

MAE exception."[31] This is significant because this case is an example of a scenario where, even after a seller made significant changes to its business operation, the Delaware court did not find that MAE was truly implicated as the reason to opt out.[32] Instead, the court affirmed the lower court opinion, finding only that "the Seller's drastic changes to its hotel operations in response to the COVID-19 pandemic without first obtaining the Buyer's consent breached the ordinary course covenant and excused the Buyer from closing."[33] Thus, although the outcome did involve the Buyer walking away from the contract, MAE was not the mechanism leading to that outcome.[34] The court also addressed the list of MAE objects articulated in the agreement, which generally define particular facets of the target company or product which must be materially adversely affected to trigger a MAE opt out for the acquiror.[35]

That is, MAE objects usually include facets such as the business' operation and financial condition, but in the agreement at issue here, the parties lumped everything together under an agreed-upon defined term.[36] However, what is novel about the analysis in this case is that the court "confirms a long-unacknowledged trend in Delaware law of essentially ignoring the detailed list of MAE Objects and merely inquiring about the adverse effect of the alleged MAE on *the value of the company* as reasonably understood in accordance with the principles of corporate finance."[37] Next, the court deviated from precedent – which was a focus on how long the target company or product's cashflows would be in a dip – and instead focused on "the *probability* that they would rebound to levels more consistent with

---

[31] *Id*. at *7.
[32] *Id.* at *1, *7 ("[T]he Seller made drastic changes to its hotel operations." "[I]t did not incorporate a Material Adverse Effect ("MAE") exception.").
[33] *Id*. at *1.
[34] *See id.* (holding breach of contract permitted Buyer to walk away from contract, not MAE exception).
[35] Robert T. Miller, *Bardy Diagnostics v. Hill-Rom: New Lessons on Material Adverse Effect Clauses*, BROOK. J. OF CORP., FIN. AND COM. L. (forthcoming Mar. 2022) ("The opinion in *Bardy* develops the law of MAEs in several significant ways. First, *Bardy* contains important lessons about MAE Objects, the aspects of the company that the definition of "Material Adverse Effect" requires to be materially adversely affected.").
[36] *Id*. ("First, the agreement between the parties substituted for the customary MAE objects (e.g., the company's business, financial condition and results of operations) a bespoke defined term.").
[37] *Id*.

historical ones (and if so, when that rebound would likely occur), it being assumed that, if they rebounded at all, they would rebound relatively quickly and once they had done so, they would stay at historical levels indefinitely."[38] Also, the court "significantly advances the law concerning how exceptions in MAE definitions will be applied."[39] That is, although courts in the past have been confused by this distinction, the court here explicitly distinguishes between (1) MAE, in capital letters, meaning the given event that had or could reasonably be expected to have a material adverse effect, and (2) the material adverse effect, in lower-case letters, inflicted on the target company or product.[40] This explicit acknowledgement is groundbreaking because it likely sets the stage for more precise use of language in negotiating these acquisition transactional agreements moving forward. Moreover, it is a distinctly new level of precision in court analysis even from well-known Delaware cases like *Akorn* and *KCake*.[41]

Additionally, and perhaps more pertinently, Covid was recently held to not constitute a material adverse event as under a given MAE provision.[42] In *Snow Phipps Group LLC v. KCake Acquisition*, in April of 2021, the Delaware Chancery Court found that the acquiree did not experience a material adverse event as they related to Covid

---

[38] *Id*. ("By contrast, *Bardy* concerned not so much the period during which the target's cashflows would be depressed but the *probability* that they would rebound to levels more consistent with historical ones (and if so, when that rebound would likely occur), it being assumed that, if they rebounded at all, they would rebound relatively quickly and once they had done so, they would stay at historical levels indefinitely.").
[39] *Id*.
[40] *Id*. ("Typically, such definitions define the capitalized term "Material Adverse Effect" to refer to an event, fact, circumstance, etc. (for short, an "event") that has, or would reasonably be expected to have, an (uncapitalized) material adverse effect on the target. Such definitions thus refer to two separate realities that are related as cause to effect.").
[41] *Id*. ("Unlike *Akorn* and *KCake*, *Bardy* thus makes clear that exceptions in MAE definitions apply to events, not the effects they cause.").
[42] Snow Phipps Group LLC v. KCake Acquisition, No. 2020-0282-KSJM, 2021 WL 1714202, at *35 (Del. Ch. Apr. 30, 2021) ("Thus, revenue declines arising from or related to changes in law fall outside of the definition of an MAE, regardless of whether COVID-19 prompted those changes in the law.").

despite a significant drop in the sales of KCake's products.[43] The reasoning was largely due to the MAE exception in the acquisition agreement which "covers effects 'arising from or related to … changes in any Laws, rules, regulations, orders, enforcement policies or other binding directives issued by any Governmental Entity.'"[44] However, Delaware courts interpret "arising from or related to" language broadly, so the court held that "revenue declines arising from or related to changes in law fall outside the definition of an MAE, regardless of whether COVID-19 prompted those changes in the law."[45] Furthermore, the court found that "[the seller] was not reasonably likely to experience a material adverse effect."[46] The court continued on to say that, "[a]s in *IBP*, DecoPac experienced a precipitous drop but then rebounded in the two weeks immediately prior to termination and was projected to continue recovering through the following year."[47] Moreover, "unlike in *Akorn*, DecoPac was not projected to face a 'sustained drop' in business performance."[48] Thus, although Covid poses many industry issues, it does not extend beyond Delaware court readings of negotiated acquisition agreements. Instead, it seems that a sustained duration of a drop in business performance is a more significant factor in determining whether a MAE clause is triggered.

Although the rulings in the *Snow Phipps* case regarding Covid may seem concerning, some may consider the holding "a relief to target companies attempting in good faith to respond to a crisis without giving remorseful buyers an excuse to walk away."[49] It is important to note, too, that while the rulings in *Snow Phipps* and the other cases addressing Covid may appear unfair to acquirer companies, they are in line with Delaware precedent – as seller or target company

---

[43] *Id*. ("Thus, revenue declines arising from or related to changes in law fall outside of the definition of an MAE, regardless of whether COVID-19 prompted those changes in the law.").
[44] *Id*.
[45] *Id*.
[46] *Id.*
[47] *Id*. at *34.
[48] *Id*.
[49] Alison Frankel, *Chancery's DecoPac opinion shows 'ordinary course' breaches will remain extraordinary*, REUTERS (May 3, 2021), https://www.reuters.com/article/us-otc-decopac-idUSKBN2CK1T7 [https://perma.cc/GZ4P-E4GF].

downturns must persist over an extended period of time in order to trigger a MAE opt out.[50]

D. General Trends, Proposed Reform Efforts/Regulations, and Their Effect on the Future of MAE: Expected Future Developments

Outside the specific parameters of the aforementioned Covid-related MAE cases, and although there is not a particular regulatory rule or law relating to Covid analyzed, the persisting global issue of Covid has seemingly had an impact on MAE. That is, one study found that approximately 67% of studied 2020-2021 transactions with MAE provisions ultimately included a carve-out for "the effects of the pandemic (and/or governmental responses to the pandemic) from the definition of a 'material adverse effect.'"[51] Moreover, the same study also found "an increase (to 95%) in carve-outs for 'changes in law,' which would include governmental responses to the pandemic such as social distancing requirements, mandatory shut downs, and other public health responses."[52] These data seem to illustrate that there is a tangible increase in the efforts of companies and their legal teams to account for the pandemic. That is, these two different carve-outs each seem to be slightly more in favor of one party – the acquirer or the target. An acquirer likely desires more opportunity to opt out of an agreement, so the carve-out regarding changes in law seems to weigh more in an acquirer's favor. Conversely, the target likely desires more limited scenarios in which an acquirer could have an opportunity to opt out of an agreement, so the carveout regarding the effects of the pandemic seems to weigh more in a target's favor.

Looking to the future of MAE doctrine, and beyond the apparent effects of Covid on how acquiring or acquiree parties are negotiating carveout language, *Bardy* will likely have an impact on

---

[50] *Id*. ("Delaware precedent, notably in [*Akorn*], insists that a company's reversal in fortunes has to be long-lasting to constitute an MAE.").

[51] Kelly F. O'Donnell, *10 M&A Trends Gleaned from the 2020 – 2021 ABA Deal Points Study*, PULLMAN & COMLEY (Jan. 5, 2022), https://www.pullcom.com/newsroom-publications-10-Trends-2020-2021-ABA-Deal-Points-Study [https://perma.cc/973B-5UFK] ("Although it wasn't measured in previous years, the Deal Points study revealed that 67% of transactions carved out the effects of the pandemic (and/or governmental responses to the pandemic) from the definition of a 'material adverse effect.'").

[52] *Id*.

MAE analysis in Delaware courts. I feel that this is a positive direction for MAE doctrine. As analysis pertains to MAE objects, courts will now likely explicitly focus on the impact on the overall value of the target company or product rather than running through the MAE objects like a checklist.[53] This will also likely influence parties in future acquisition transactional agreements to not deviate from standard MAE object language, unless dealing specifically with target company or product value, since courts may still interpret just the impact on company or product value.[54] Additionally, in determining whether a given MAE provision is triggered, Delaware courts in the future will likely abide by the precedent set in *Bardy* regarding the distinction between MAE events and material adverse effects on expected cashflows of the target over time stemming from those events.[55] Further in this regard, the *Bardy* court likely set a precedent that "exceptions in typical MAE definitions apply to *events*, not their effects."[56] Finally, *Bardy* further cemented the Delaware court trend of setting a very high bar for acquiror opt outs under MAE provisions. That is, based on the court's opinion here:

> [I]f a company suffers a veritable catastrophe between signing and closing and loses all or almost all its value, the acquirer would still have to close if the catastrophe results from an event excepted under the MAE definition, even if the exception is qualified by

---

[53] Miller, *supra* note 35, at 20 ("First, just as the courts have not attempted to distinguish material adverse effects on one MAE Object from material adverse effects on other MAE Objects as the language of the typical MAE definition would seem to require but rather have merely inquired whether the *value of the company* has declined in an amount that would be material to a reasonable acquirer, so too will courts tend to interpret unusual or bespoke MAE Objects in a manner that leads them to just the same inquiry.").

[54] *Id*. ("If parties really do want a provision the meaning of which is different from that a typical MAE clause, tinkering with the MAE Objects is not the way to get it. Rather, the entire MAE clause, along with all its customary defined terms, should be deleted to make it clear that Delaware's MAD jurisprudence is intended *not* to apply.").

[55] *Id*. at 20-21 ("The relevant question is then not really how much the expected cashflows in any particular period have declined, nor even for how long the expected cashflows have declined, but rather how much the present value of *all* future cashflows of the company has declined.").

[56] *Id*. at 21.

> a disproportionality exclusion, provided that comparable companies have suffered comparable catastrophes.[57]

E. Conclusion

MAE provisions are a constant part of acquisition agreements, and MAE doctrine has recently been subjected to change. Delaware courts are seemingly unwilling to consider significant, negative business operation changes by the seller company due to Covid as a noteworthy reason for an acquirer to opt out through a given MAE provision. Additionally, Delaware courts are seemingly moving towards an adjusted method for analyzing material adverse effects, versus events, under MAE provisions. Considering the still-unstable economy due to Covid coupled with continued acquisition-based business transactions around the world, MAE doctrine is worthy of attention.

Cole Haaf[58]

---

[57] *Id*. at 22.

[58] Student, Boston University School of Law (J.D. 2023).