

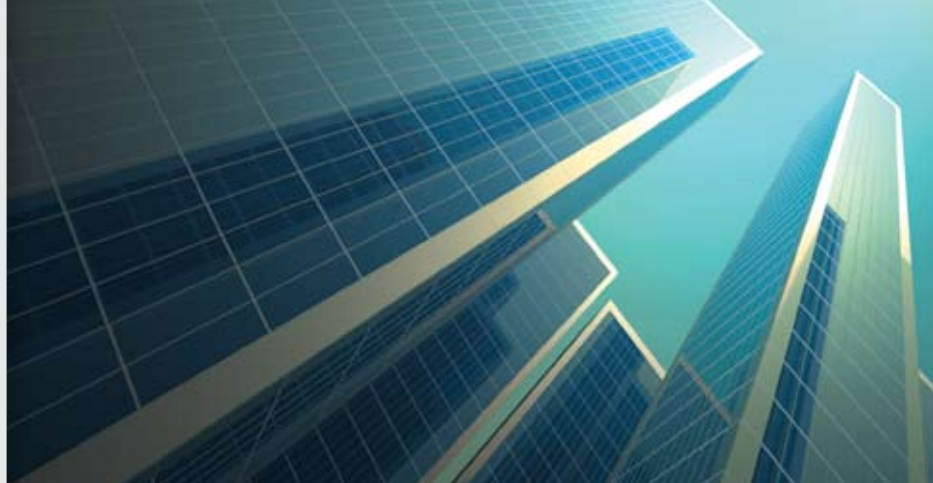
2010 Nixon Peabody MAC Survey

A Nixon Peabody study of current
negotiation trends of Material Adverse
Change clauses in M&A transactions

NIXON PEABODY

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We initiated this annual survey following the dramatic stock market decline in 2000 and the events of September 11, to track their effects on the negotiation of MAC provisions in M&A deals. Since that time, this annual exercise has undergone significant expansions in its scope and analysis in its effort to identify current negotiation trends. Between 2004 and 2007, our surveys showed increasingly seller-favorable formulations with less expansive inclusion language and an increasing list of exclusions. In the 2008 and 2009 surveys we saw a reversal of that trend with a decreasing list of exclusions, indicating an increase in buyers' bargaining power. In this year's survey, we see a higher frequency of MAC exceptions and a slight increase in certain pro-seller MAC definitional elements over the prior year.

By way of explanation, a material adverse change ("MAC") or material adverse effect ("MAE") provision in an acquisition agreement generally serves two separate functions. In the first, the MAC or MAE definition serves as a qualifier for various representations and a carve-out for covenants, defining a threshold for determining the scope of disclosure or compliance. For example: "The Company's contracts are in full force and effect, except as would not have a Material Adverse Effect." In the second, the MAC provision is used to delineate the circumstances that, upon their occurrence, permit a buyer to withdraw from the transaction without penalty. This latter use is known in common parlance as the "MAC out" and appears in the buyer's conditions precedent to close, i.e., "there shall not have occurred a Material Adverse Change in the Company." The effects of the MAC out are then tempered by a listing of specific events, the "MAC exceptions," that preclude a buyer from backing out of a deal

Nixon Peabody's Ninth Annual MAC Survey provides an analysis of MAC clauses in publicly disclosed M&A transactions. The results generally reflect a slightly more "seller-friendly" market in comparison to the prior year.

or renegotiating even if a MAC has occurred. Together, the MAC out and the MAC exceptions serve to allocate and fine tune the risk of loss between buyer and seller resulting from adverse changes, if any, in the seller's business between signing and closing.

The elements of MAC clauses are generally heavily negotiated, with sellers attempting to narrow the MAC definitional elements and expand the exceptions thereby shifting more risk to the buyer. Buyers in turn attempt to shift the risk to their seller by expanding the elements and narrowing the exceptions.

Methodology

As in prior years, we surveyed agreements with transaction values of \$100 million or greater based on agreements dated between June 1 of the prior year (2009) and May 31 of the current year (2010). This year, we generated a list of deals executed between June 1, 2009, and May 31, 2010, from publicly available information submitted to the Securities and Exchange Commission and reviewed every deal for which a transaction agreement was publicly available. Of the 368 deals on the list we were able to locate and examine 345 agreements including asset purchase, stock purchase, and merger agreements. The surveyed transactions represent many significant industries and range in value from \$100 million to \$55.3 billion. Although this analysis is not technically scientific and does not include private transactions for which no agreement was made available, we believe the results are statistically representative of the climate of M&A transactions during the period.

We also separately analyzed the top 100 deals on our list (measured by dollar size of the transaction). This year, we compared the top 100 deals with all 345 deals reviewed during the period examined.

Summary of results

Of the 345 agreements surveyed, 295 (85%) contained a MAC on the "business, operations, financial conditions of the Company" as a definitional element. This represents a slight increase from last year's survey, which showed this inclusion in only 79% of agreements surveyed. The survey reflected a decline in the use of pro-seller "disproportionately affect" language in MAC exceptions. On the other hand, the use of various pro-seller MAC exceptions, including exceptions relating to changes in the economy; in legal developments; and resulting from terrorism, acts of war, and political conditions generally increased across the board, which may signal that sellers are gaining greater negotiating leverage. These results are similar to what we saw in our 5th MAC Survey, covering deals between June 1, 2005, and May 31, 2006. In addition, there was a substantial decline in the use of the pro-buyer "would be reasonably expected to" formulations of the MAC definition. Finally, surprisingly, there continues to be a very limited attempt in agreements to craft MAC clauses and closing conditions which address court rulings, such as the Delaware *Hexion* decision, limiting the enforceability of MAC clauses.

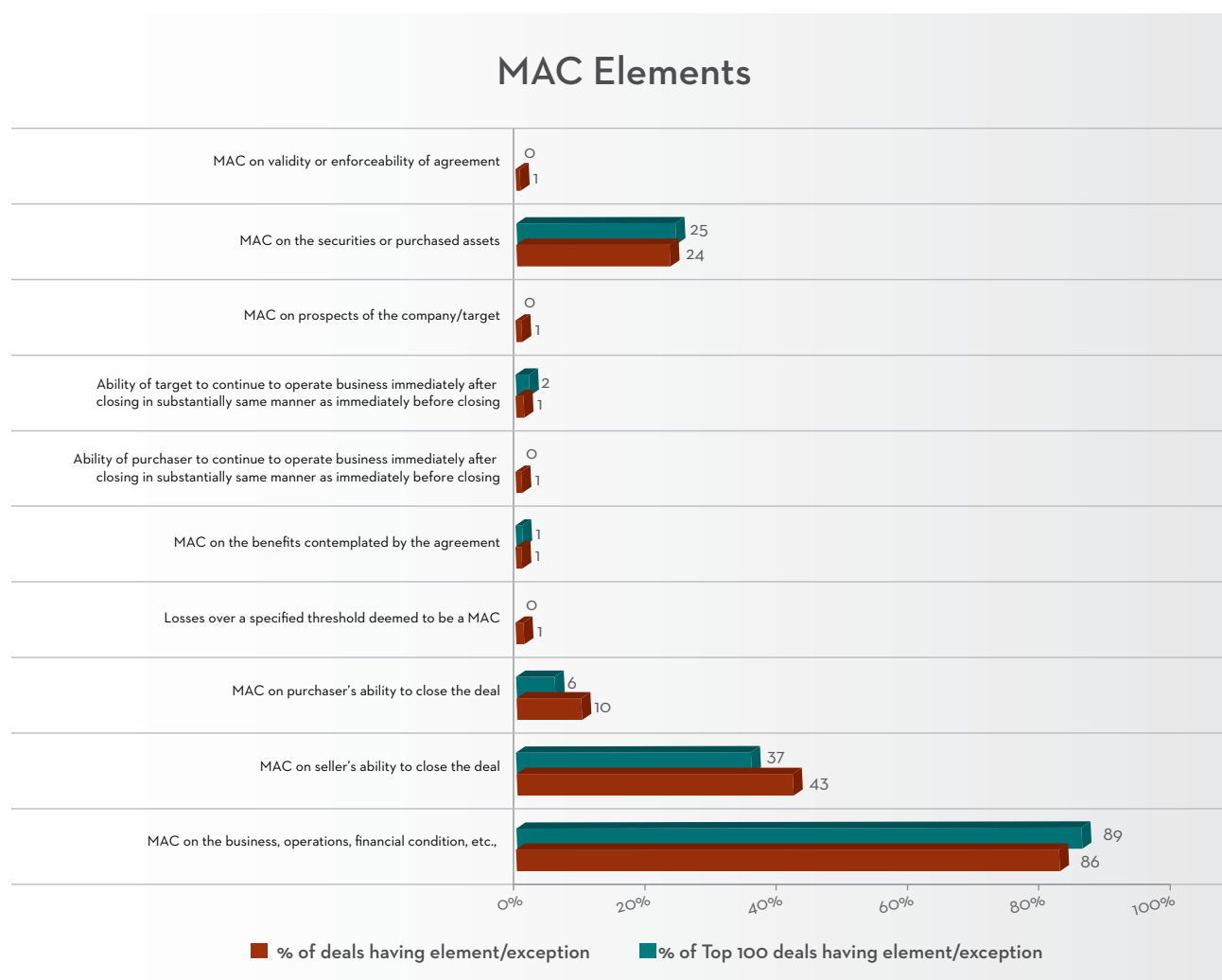
Exceptions to the MAC definition increased

The MAC definitional elements appeared with the same frequency in the top 100 deals and the full sample of 345 deals. At the same time, the exceptions appeared at a slightly higher frequency in the top 100 deals. On average, approximately 9.9 exceptions were noted per agreement for the top 100 deals while only 9.1 exceptions appeared per agreement for all 345 agreements reviewed as a whole. Last year, approximately 9.2 exceptions were noted per agreement for the top 100 deals and only 7.3 for all agreements reviewed.

It appears that the recession is still impacting the operating results of many potential targets, thereby reducing the number of attractive M&A candidates and creating

a more competitive market for those still in play. On the whole, we continue to see that targets that have been able to maintain or grow their operations generally enjoy significant bargaining power in the current market, while those that have done more poorly but are nonetheless forced to enter the market—whether because of credit problems, management changes, or otherwise—find themselves at the mercy of more aggressive buyers. Unfortunately, it is not always possible to distinguish these two situations in analyzing the documentation from completed transactions.

Set forth below is a table detailing the prevalence of the MAC elements in our survey:



Reduced appearance of “would reasonably be expected to” language in the MAC definitions

In conducting our review, in addition to examining the elements of and exclusions from MAC definitions, we also sought to evaluate certain uses of MAC provisions in acquisition agreements. One example is the forward-looking language that a given event “would reasonably be expected to have a Material Adverse Effect” on the target, as opposed to simply stating that such event has in fact had such an effect. This nuance is important because the “would reasonably be expected to” formulation permits the buyer to take into account effects on the target that are foreseeable but are not yet reflected on the balance sheet or income statement. For example, notification from a major customer that it will cease buying from the target “would reasonably be expected to” result in a loss of sales and resulting profits, but may not yet have had that effect at the time of closing. The “would reasonably be expected to” formulation showed up in only 13% of the agreements surveyed this year compared to 22% in the prior year. This result is similar to what we saw in the 2008 survey, covering deals between June 1, 2007, and May 31, 2008

Limited response to the *Hexion* decision

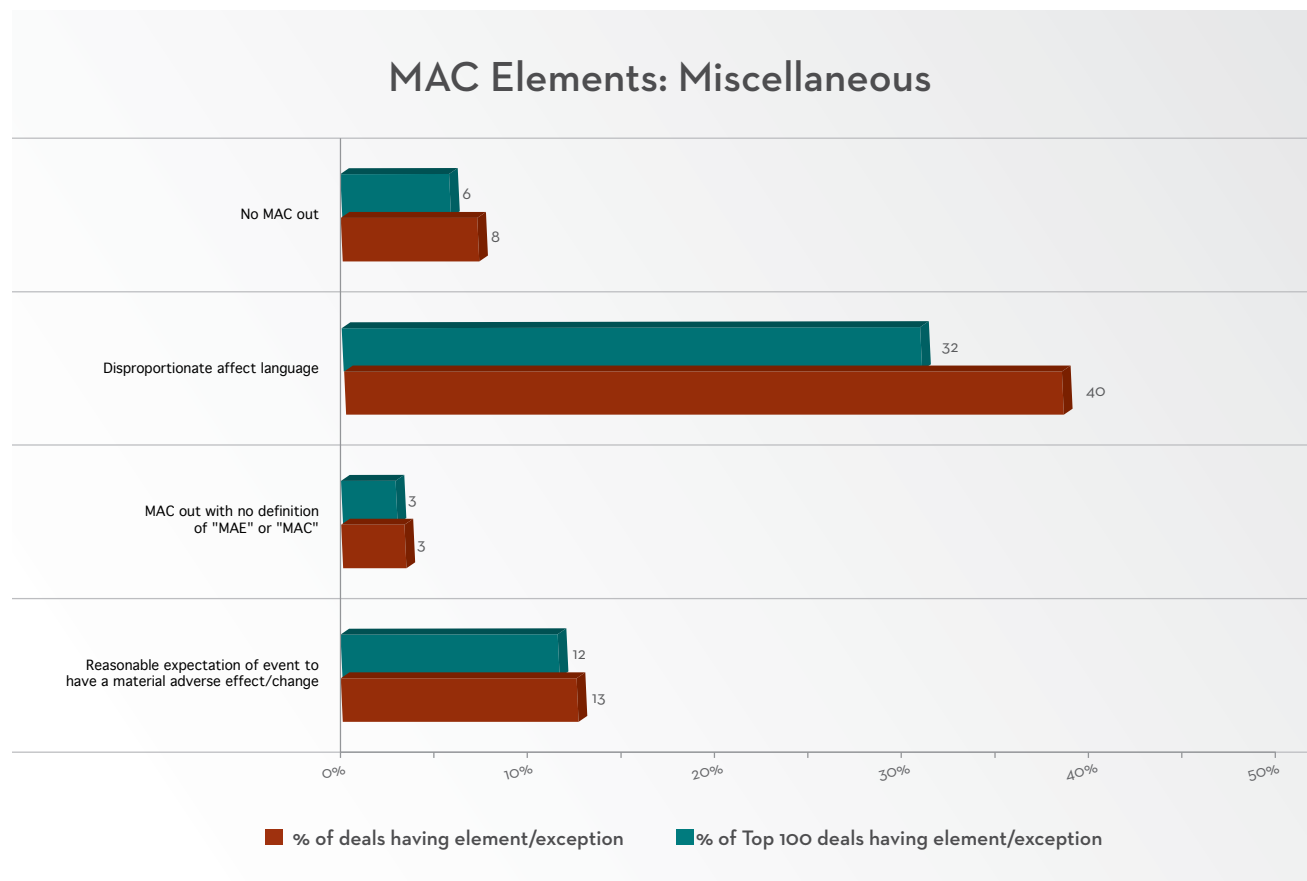
In our 2008 survey, we addressed the Delaware Chancery Court’s decision in *Hexion Specialty Chemicals, Inc. et al. v. Huntsman Corp.*, C.A. No. 3841-VCL (Sept. 29, 2008). The *Hexion* decision, combined with other decisions like the 2007 decision of the Tennessee Chancery Court in *Genesco, Inc. v. The Finish Line, Inc.*, et al., C.A. No. 07-2137-II (September 21, 2007), have brought into question the traditional approach to the MAC out. The *Hexion* court confirmed that no Delaware court has ever found a MAC to have occurred in the context of a merger agreement. It also placed the burden of proof on the buyer relying on the MAC to excuse its performance and narrowly interpreted the traditional MAC to require a material distortion measured by the target’s past performance that is likely to cause substantial long-term effects on the earning power of the target. Since *Hexion*, we have expected the traditional MAC out to be modified over time, either by adding more specific elements, such as a failure to meet specific financial milestones, decreases in sales levels beyond a certain threshold, or customer defections and other “quantifiable” terms that may unequivocally excuse performance, or by incorporating these specific tests into additional closing conditions. However, these expected modifications to the traditional MAC out do not appear to be reflected in this year’s data. We have found few examples of more pointed MAC language and very few specifically targeted closing conditions. We recognize that buyers have other ways to supplement the MAC provisions, including more specific closing conditions, seller bring-down representations, and termination rights through the use of a reverse break-up fee arrangement, but are somewhat puzzled by the absence of any discernable trend in this area. For more information on supplementing the MAC out please contact one of our attorneys.





Lastly, we observed that leaving the term “material adverse change” undefined continues to be rare, with 3.5% of the surveyed deals not defining what constituted a MAC, a result similar to the 3% finding on last year’s survey.

Set forth below is a table detailing the findings in our survey in respect of the miscellaneous definitional matters described above:



“Disproportionate affect” language limiting the exclusions declined

On the exclusion side, we found that 40% of the time the exclusions were limited in whole or in part to specified events that did not “disproportionately affect” the target. This qualifier appeared in 48% of transactions surveyed for the prior year and 51% two years ago. This limitation is intended to ensure that the appli-

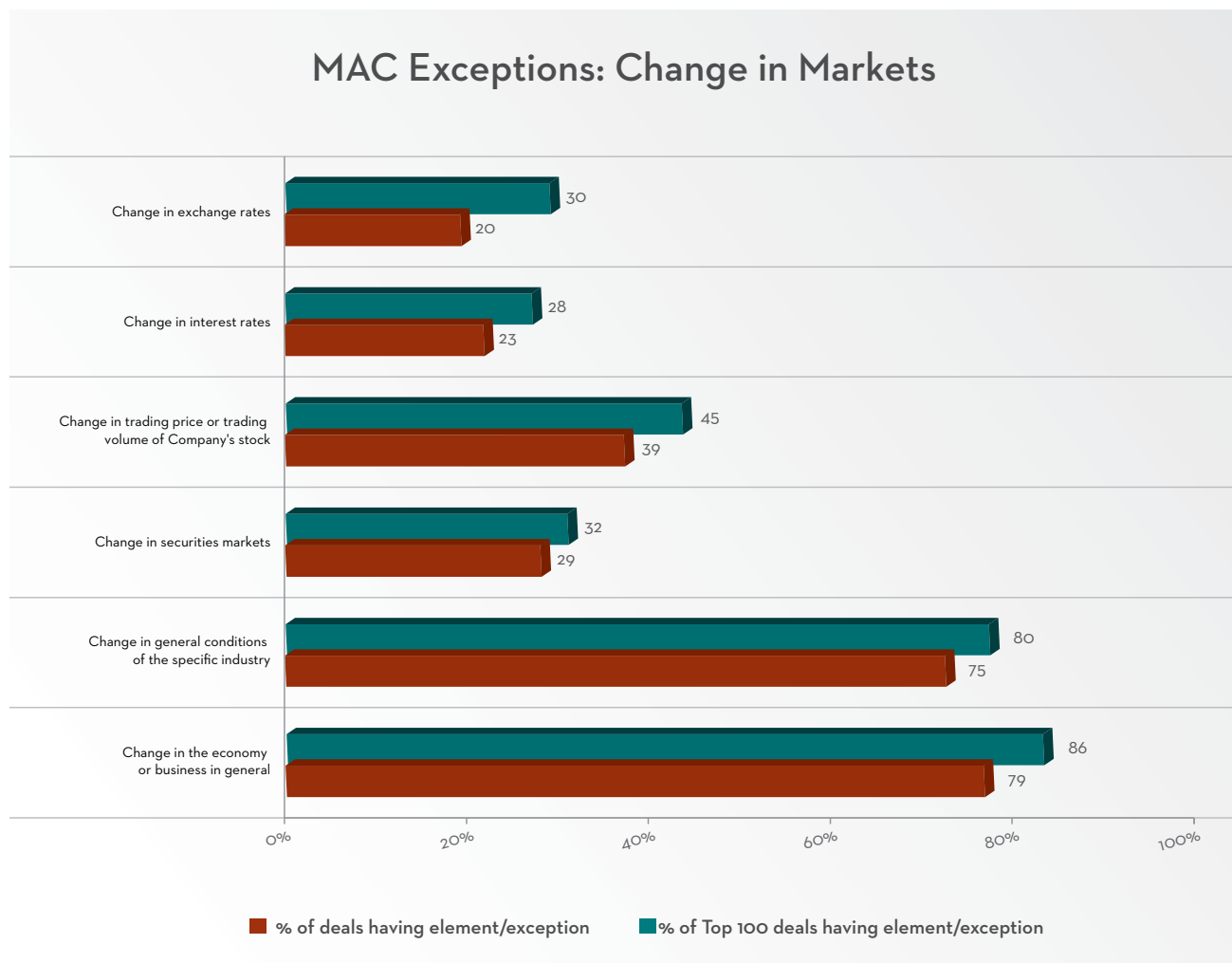
cable exclusions, e.g., changes in law or regulations and changes in the general conditions in a specific industry, apply only where the target is caught up with the rest of its industry, but do not excuse the seller if it is just less nimble than its competitors.

Exceptions relating to change in the economy

Last year, MAC exceptions for “changes in the economy or business in general” and “changes in general conditions of the specific industry” appeared in 65% and 57%, respectively, of transactions agreements reviewed. This year these exceptions increased to 79% and 75%, respectively, of transaction agreements reviewed. The MAC exception for “change in trading price or trading volume of Company’s stock” remained relatively unchanged at 39% of all agree-

ments surveyed. However, for the MAC exception relating to a change in securities markets, we saw a decrease with only 29% of transaction agreements surveyed this year including that MAC exception, in comparison to the 45% of transaction agreements noted last year.

Set forth below is a table detailing the prevalence of MAC exceptions found in our survey that relate to “Changes in the Economy”:

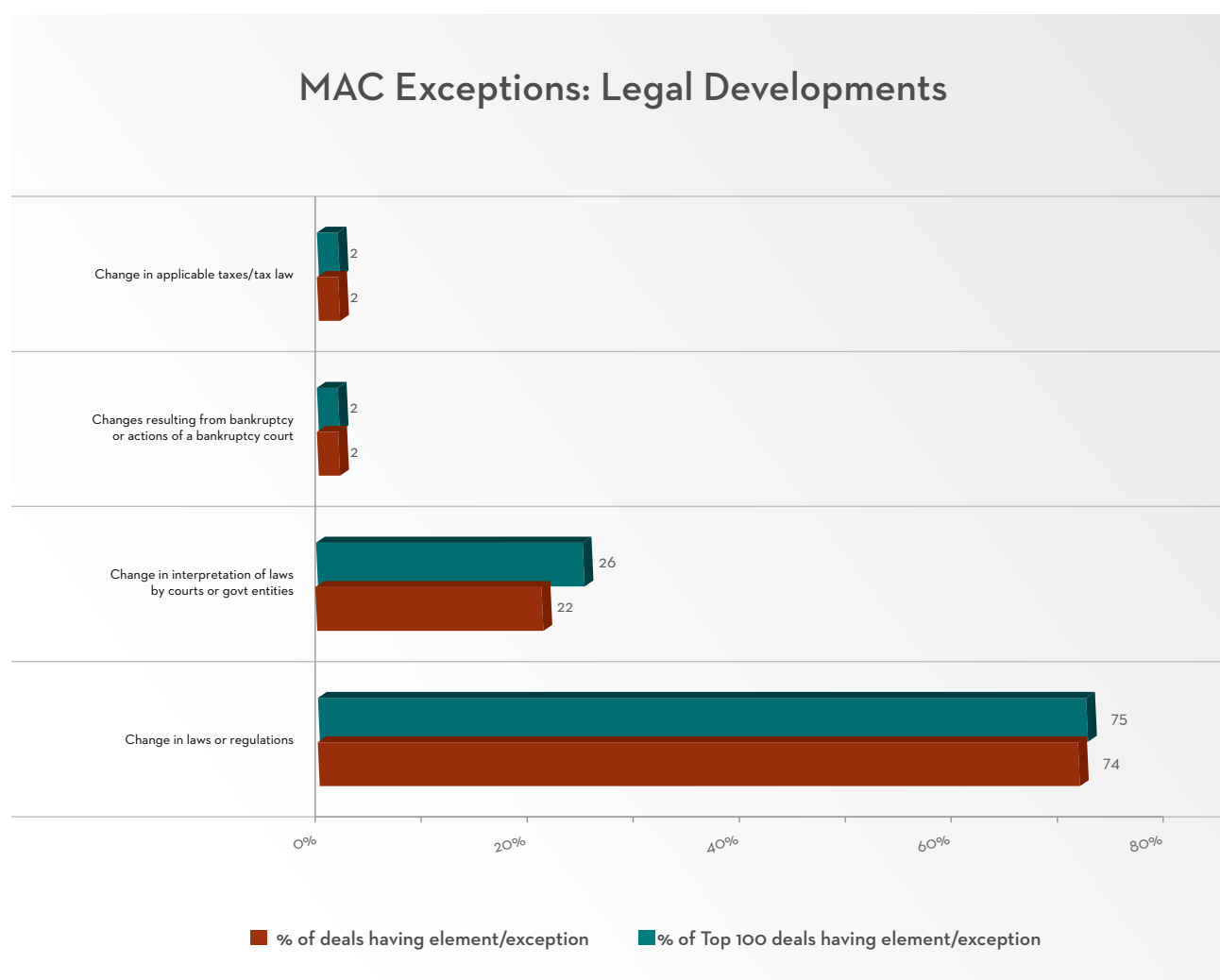


Exceptions relating to changes in legal developments

The MAC exception for “changes in laws or regulations” has grown steadily over the course of the last three years, appearing in 42% of transaction agreements in 2006, 59% in 2007, and 63% in 2008, while declining slightly to 60% in 2009. This year, the MAC exception for “changes in laws and regulations” stands at 74% of the deals surveyed. The pattern for the exception for “changes in interpretation of laws by courts or government entities” has been more inconsistent over the same period, appearing in 20%

of transactions surveyed in 2006, 32% in 2007, 27% in 2008, and 43% in 2009. This year, the MAC exception for “changes in interpretation of laws by courts or government entities” appears in only 22% of transactions agreements, a reversion back to 2006.

Set forth below is a table detailing the prevalence of MAC exceptions found in our survey that relate to “Changes in Legal Developments”:



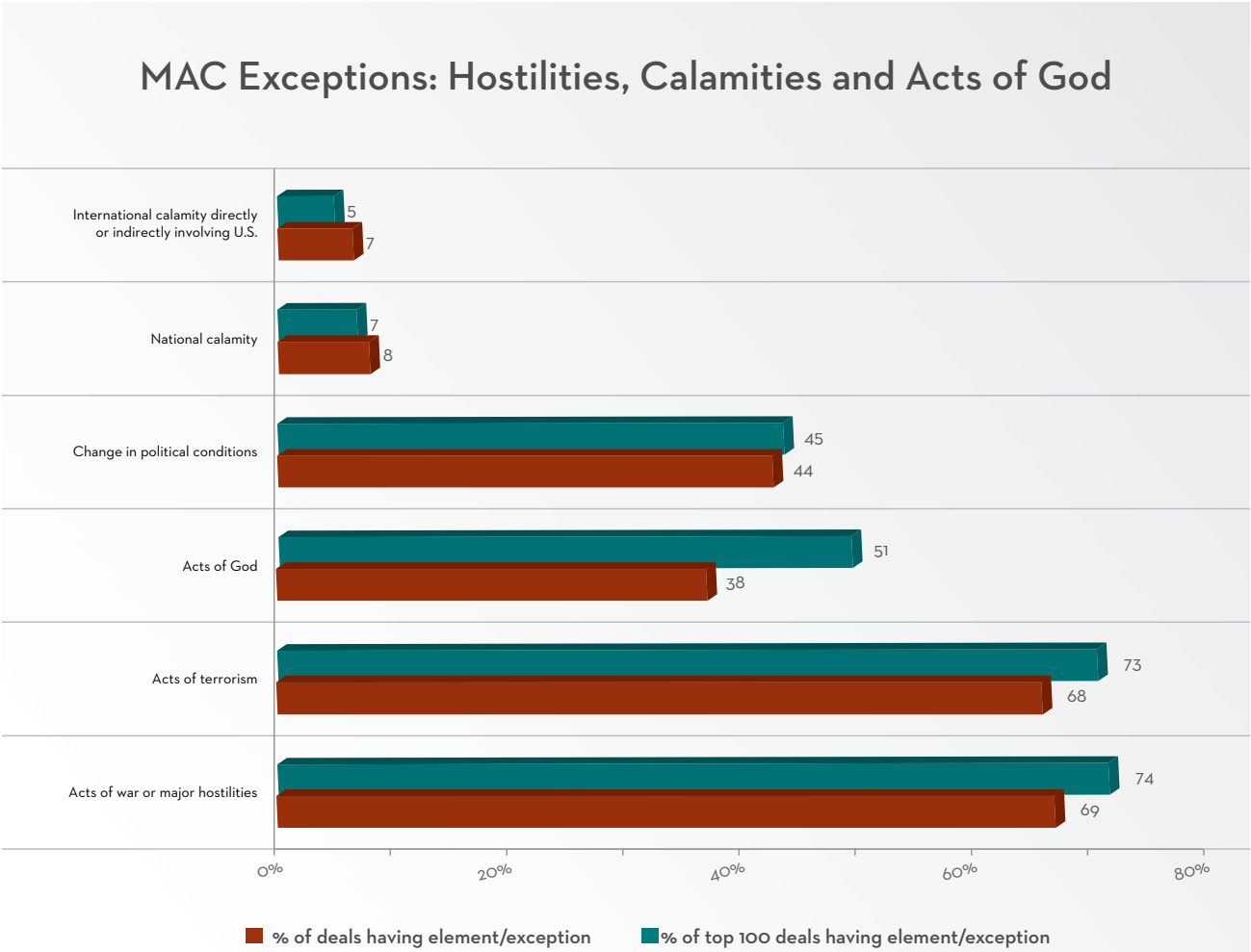
Exceptions for changes resulting from terrorism, acts of war, and changes in political conditions increase significantly

In this year’s survey, we noted an increase in MAC exceptions for “changes resulting from terrorism, acts of war, and changes in political conditions.” The MAC exception for (i) changes due to acts of terrorism in the United States or abroad appeared in 68% of transaction agreements surveyed this year, up from 55% last year; (ii) “acts of war” increased to 69%, up from 57% last year; and (iii) “changes in political conditions” increased to 44% of agreements surveyed this year, up from 28% last year.

In addition, this year’s survey showed a marked increase for “acts of God.” That exception appeared in 38% of

agreements surveyed this year, up from only 19% of agreements surveyed last year. This increase may be explained by the unfortunate earthquakes that devastated Haiti (January 2010) and Chile (February 2010), and the resulting heightened consciousness of the potential global economic impact of such events.

A table detailing the prevalence of MAC exceptions found in our survey that relate to “Changes arising from Hostilities, Calamities, and Acts of God” follows:



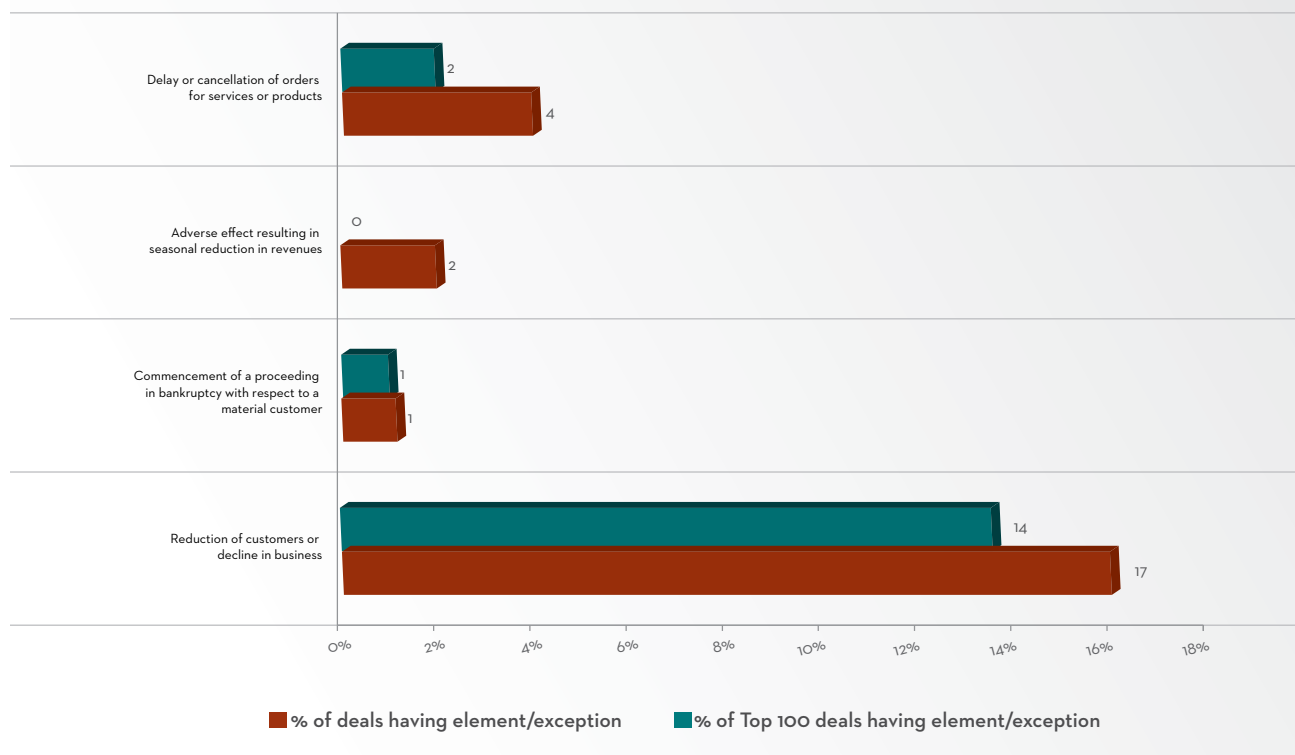
Conclusions and notable comparisons with the top 100

Just as in last year's survey, MAC exceptions appeared at a slightly higher frequency within the top 100 deals in comparison to total deals surveyed. Notable examples include exceptions for "changes in exchange rates,"

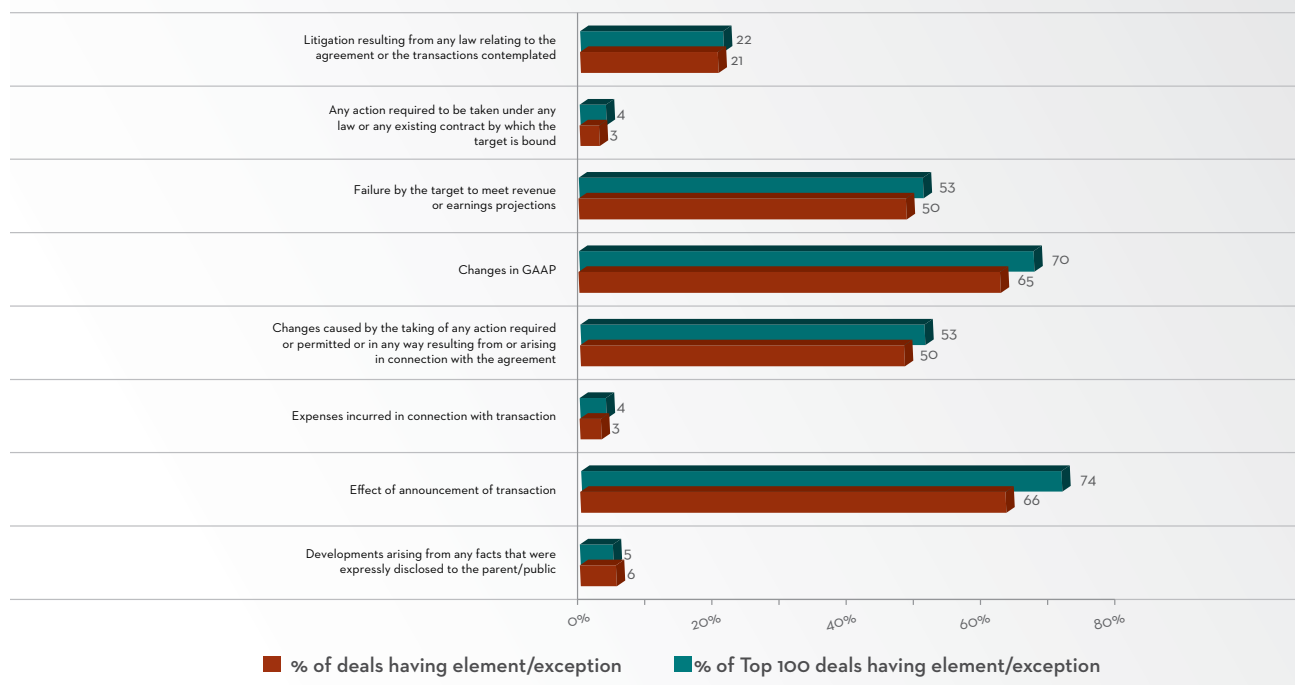
"changes in GAAP," and "changes in trading price or trading volume of Company's stock." The following chart shows the remaining results of our survey:



MAC Exceptions: Changes in Ordinary Course of Business



MAC Exceptions: Miscellaneous



Mergers & Acquisitions

Nixon Peabody is considered to be a thought-leader in the mergers and acquisitions marketplace for its continuing efforts to maintain in-depth awareness of the current legal landscape affecting M&A transactions. Our annual transactions surveys give us keen insights about deal terms and conditions that our clients rely upon for optimizing their transactions.

We devise innovative solutions for overcoming the challenges and issues that arise in an acquisition or divestiture resulting in faster, smoother, and more cost-efficient transactions. We provide counsel on strategic and financial acquisitions, divestitures, and investments ranging in value from a few million to billions of dollars.

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The group brings together an interdisciplinary team experienced in all areas of corporate finance, business counseling, corporate governance, securities, tax, ERISA, labor and employment, real estate, technology, intellectual property, and litigation.

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