




# Sixth Annual MAC Survey

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

NIXON PEABODY<sup>SM</sup>  
>>>>>> SURVEYS



Nixon Peabody's Sixth Annual MAC Survey provides an expanded analysis of publicly disclosed M&A transactions and finds a trend toward more seller-friendly terms, which continues the trend found in last year's study.

As in years before, we are pleased to announce the completion of our annual MAC study of agreements with transaction values of \$100 million or greater based on agreements dated between June 1 of the prior year and May 31 of the current year. We initiated this annual survey because of 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 of scope and analysis to help identify current negotiation trends and the concomitant advantages and disadvantages provided to transacting parties in mergers and acquisitions.

By way of explanation, a material adverse change ("MAC") or material adverse effect ("MAE") provision in an agreement generally comprises two elements. In the first, the MAC or MAE definition describes the circumstances that would constitute a material adverse change or effect on the target. This definition is used in the representations and warranties of the target or sellers, i.e., "The company's material contracts are in full force and effect, except as would have a Material Adverse Effect." The definition is also 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., "that there shall not have occurred a Material Adverse Change to the company." The flip side of the coin is the listing of specific events — the "MAC exceptions"— that would prohibit a buyer from backing out of a deal.

The elements of MAC clauses generally are negotiated heavily, with sellers attempting to narrow the MAC definitional elements and include as many exceptions as possible, and buyers doing the reverse. This year we have again compared our random sampling of 413 deals with the top 100 deals (measured by dollar size of the transaction) during the period examined. In comparison to the sampling as a whole, we have seen that these top 100 deals generally followed the same percentage trends of the MAC definitional elements and had a slightly higher percentage trend in the MAC exceptions, but in certain categories, contained significantly more MAC exceptions. These findings indicate, again, that in larger deals, sellers have more bargaining power.



## Impact of Credit Crisis

We completed this year's survey before the onset of the credit crisis that began in July 2007. As such, we have not reviewed agreements since that date to determine the impact the crisis will have on deal terms in general and MAC clauses in particular. However, we do believe that the credit crisis will have a chilling effect on the larger transactions and would expect that the overheated pro-seller market will cool off significantly as a result of less leverage being available to private equity buyers. Accordingly, we would expect deal terms (including the MAC provision) to become more buyer-friendly. The extent and swiftness of the change is difficult to predict and may take some time to work its way into the agreements themselves.

For deals that have already signed but have not yet closed, we would expect that both buyers and sellers are carefully examining the closing conditions and MAC clauses in the agreements. While we doubt that the current credit crisis would actually result in a Material Adverse Effect on many target companies, we believe private equity buyers may look to the MAC clause as leverage to renegotiate the deal to achieve more favorable terms so that the transaction continues to work from a financial perspective. As such, sellers will face a difficult decision either to litigate to force the buyer to abide by the terms of the original transaction or to accept a price cut. This decision will be greatly influenced by how successful the seller was in obtaining many of the carve-outs discussed in our survey.

We will be monitoring the changes carefully and will report back in our next annual update.

## Methodology

In completing this year's survey, we examined 413 asset purchase, stock purchase and merger agreements. The surveyed transactions represent all significant industries and range in value from \$100 million to \$32.9 billion. The top 100 agreements were derived from the list of top deals announced each month in *Mergers & Acquisitions: The Dealmaker's Journal*.

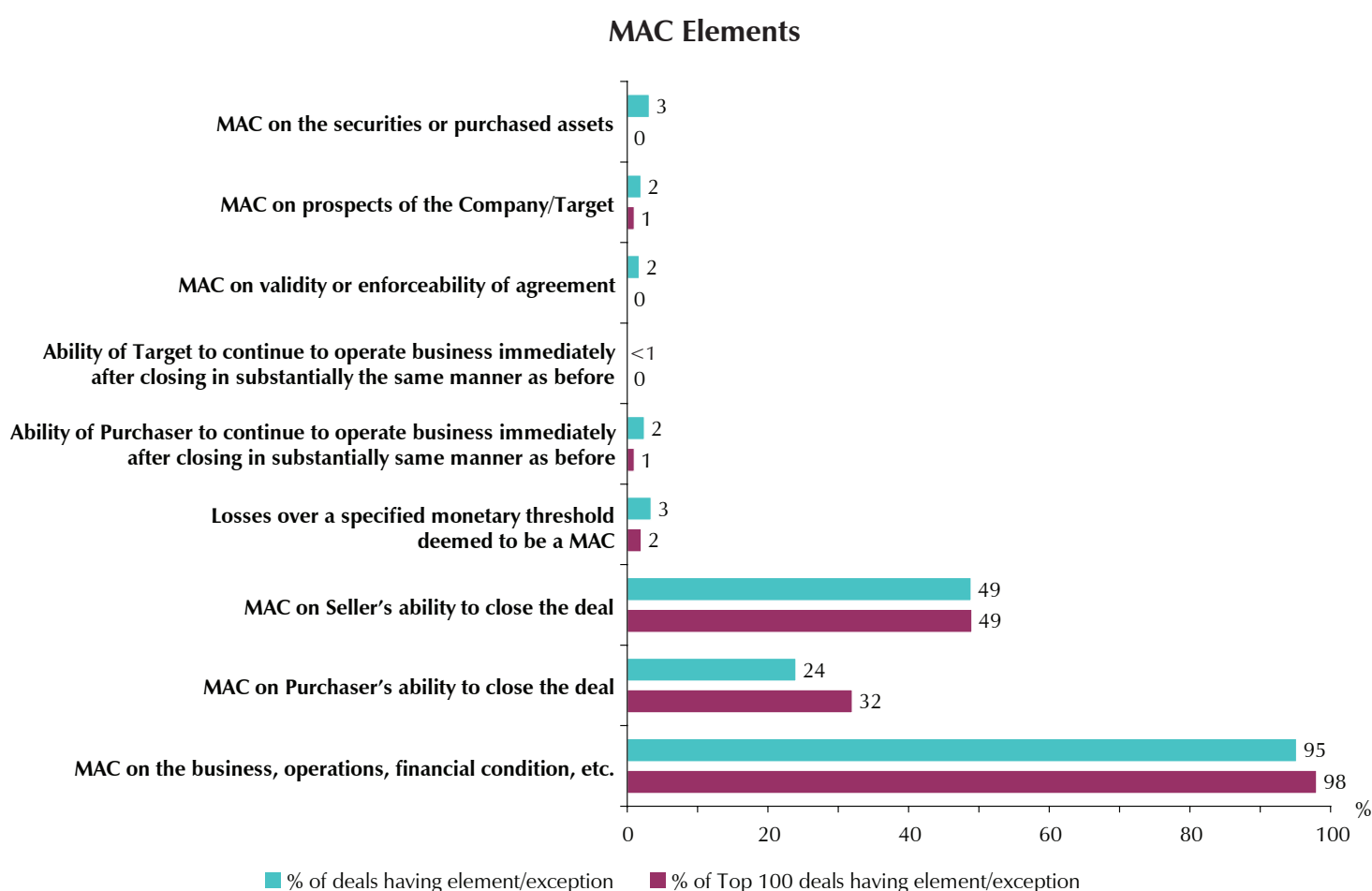
In selecting our 413-agreement sample, we made every attempt to obtain a random and unbiased sample. To do so, we generated a list of deals signed between June 1, 2006 and May 31, 2007 from publicly available information submitted to the Securities and Exchange Commission and randomly selected agreements from that list. Although this analysis is not technically scientific, we believe that the results are statistically representative of the current climate of M&A transactions.

# Results

In the agreements surveyed, the MAC definitional elements were generally narrower than last year, which indicates only a slight advantage gained by sellers. This advantage is buttressed, however, by increases across the board in MAC exceptions. Therefore, the slight narrowing of MAC definitional elements combined with the significant increases in MAC exceptions signifies an increasing negotiating advantage for sellers.

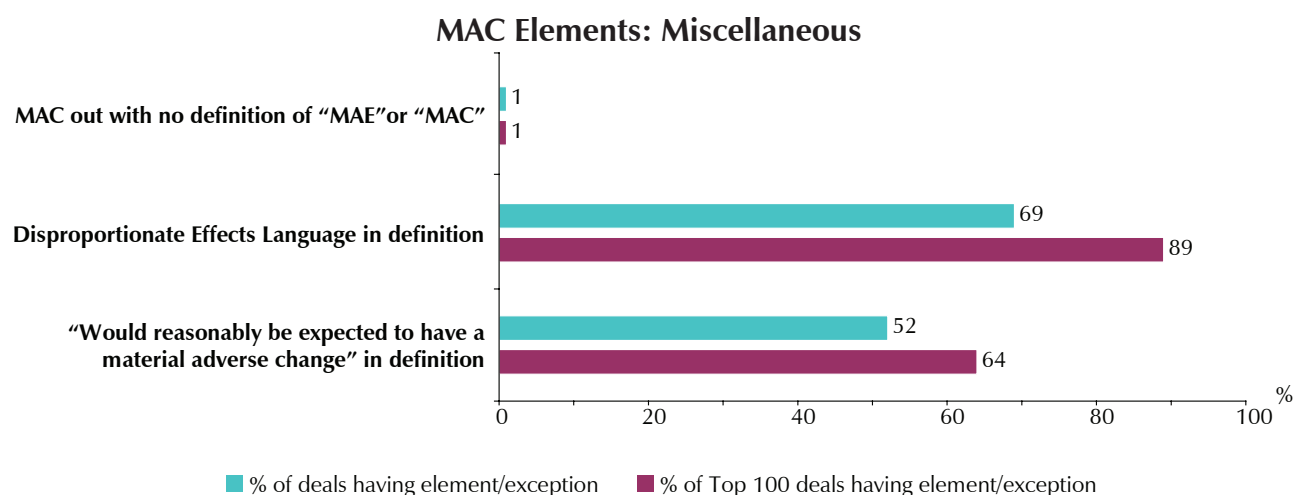
The continued shift toward seller-friendly terms noted over the past two years may be due to increased competition in the private equity market. With more buyers and higher fund values, there is more money available for a limited number of sellers. Buyers are finding that they have to offer sellers top prices and seller-friendly terms in order to compete.

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



In conducting our review this year, we also sought to determine how often certain highly negotiated provisions appeared in MAC definitions. One example is the language that a given event “would reasonably be expected to have a Material Adverse Effect” on the target—as opposed to simply stating that it has had such an effect. This nuance is important because the “would reasonably be expected to” formulation puts the onus on the seller to think thoroughly through the effects of certain events. For example, if there were a threatened litigation, no event actually affecting the target’s balance would have occurred. However, if the case were a strong one, it would reasonably be expected to have an MAE. We found that 52 percent of the agreements we reviewed included the “would reasonably be expected to” formulation. Likewise, when reviewing certain items like changes in markets or the target’s industry, we found that 69 percent of the agreements we reviewed included a qualification to exceptions that such events would not be considered MACs if they disproportionately affect the target. An example of such a carve-out from the MAC out would be “changes resulting from general economic, financial, regulatory, or market conditions, provided that such changes shall not have affected the target in a materially disproportionate manner as compared to other companies operating in the target’s lines of business.” The “disproportionate effects” language is a sophisticated tool for the buyer to push back on what would typically be a seller’s negotiation victory. Lastly, we observed that it is extremely rare in today’s market for the term “material adverse change” to be undefined.

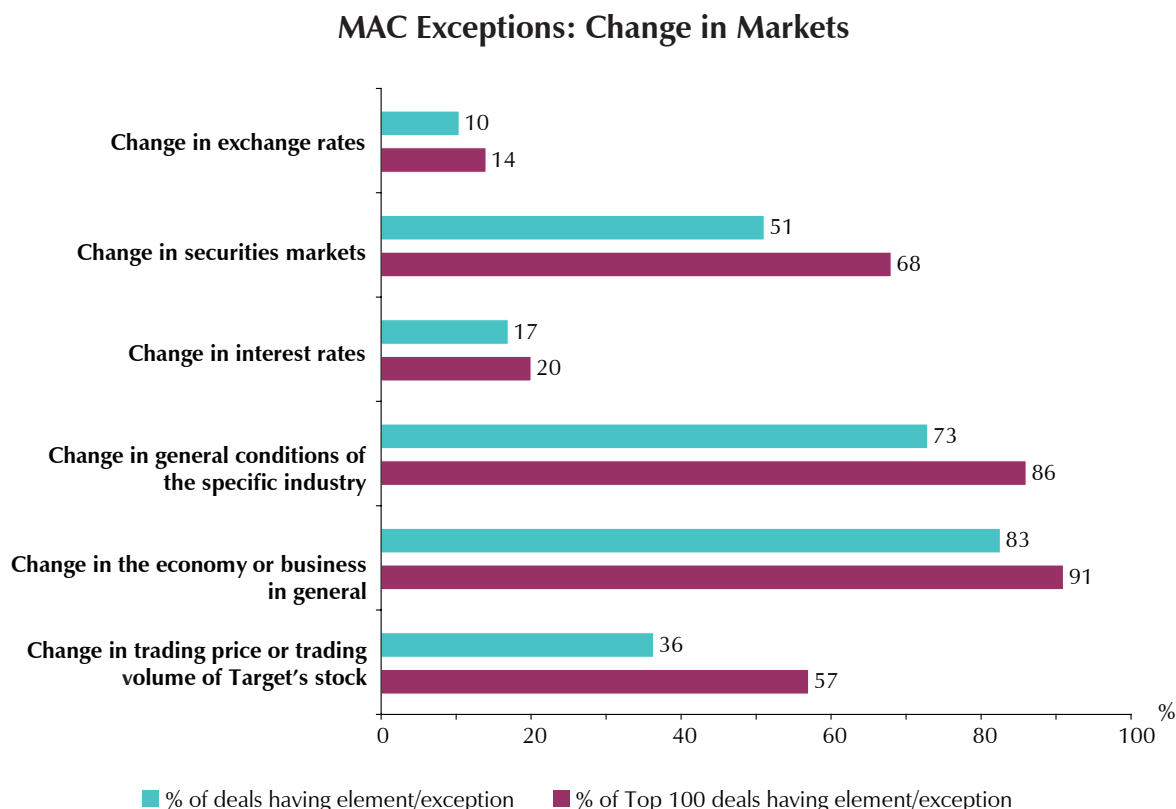
Set forth below is a table detailing the findings in our survey in respect of the miscellaneous definitional matters above described:



## Increase in exceptions relating to change in markets

This year marked an increase in MAC exceptions for “changes in securities markets” and “changes in trading price or trading volume of target’s stock.” Of the total deals examined, 51 percent included a MAC exception for “changes in securities markets,” while 36 percent included “changes in trading price or trading volume of target’s stock” as an exception. The occurrence of the foregoing “Changes in Market” exceptions increased 24 percent and 18 percent, respectively, when compared to last year’s survey. This noteworthy increase may indicate growing concerns in the volatility of the public markets today.

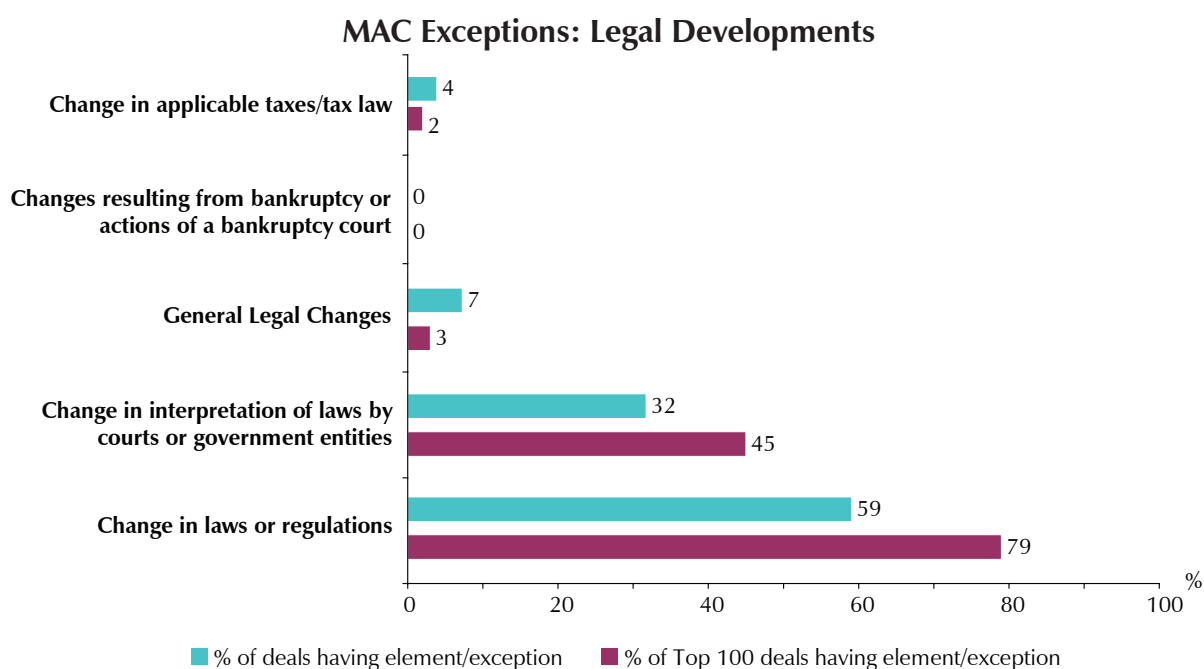
Set forth below is a table detailing the prevalence of MAC exceptions found in our survey which relate to “Changes in Markets”:



## Increase in exceptions relating to changes in legal developments

During the past two years, the MAC exceptions for “changes in laws or regulations” and “changes in interpretation of laws by courts or government entities” have steadily increased. The “changes in laws or regulations” MAC exception is up 34 percent from two years ago (17 percent from last year) and was found in 59 percent of agreements surveyed. Likewise, the MAC exception “changes in interpretation of laws by courts or government entities” is up 22 percent from two years ago (11 percent from last year) and was found in 32 percent of agreements we surveyed. In addition to these increases, a new, all-encompassing MAC exception for “general legal changes” was found in 7 percent of all agreements reviewed. Thus, 66 percent of the agreements reviewed contained some sort of MAC exception to “Changes in Legal Developments,” an increase of 19 percent over last year. We note, however, that in the top 100 deals this trend was even more dramatic—82 percent of agreements had some type of MAC exception to legal developments, an increase of 49 percent over the year prior. This shift may be a reaction to the changing legal landscape in what has been a watershed year in changing laws—whether foreign, domestic, securities rules and regulations, privacy laws or even, as we have recently observed, in the tax code.

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



## **Increase in exceptions for changes because of terrorism, acts of war, changes in political conditions, national and international calamities and acts of God**

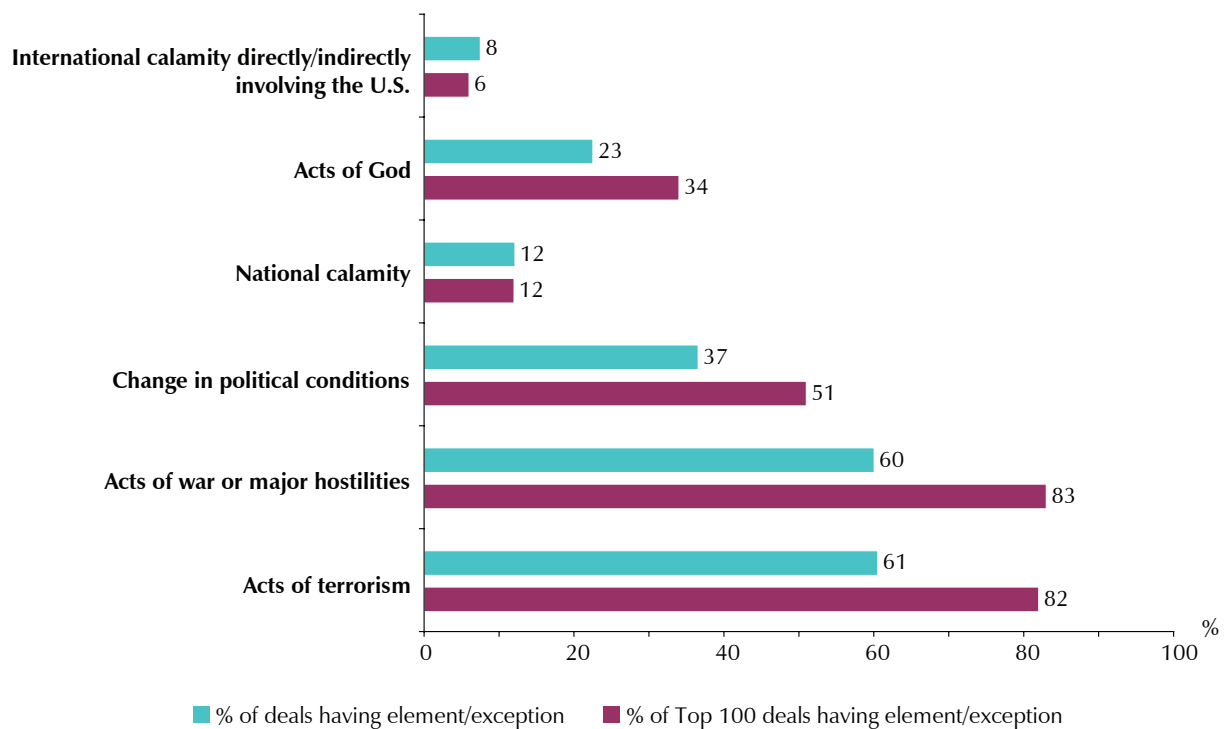
In line with last year's trend, there was an across-the-board increase of MAC exceptions for changes resulting from terrorism, acts of war, changes in political conditions, and international calamities. The frequency of MAC exceptions for changes due to acts of terrorism in the United States or abroad rose to 61 percent of agreements surveyed, compared to 35 percent last year. Similarly, the number of agreements that contained exceptions for changes due to "acts of war or major hostilities" increased from 35 percent of last year's surveyed agreements to 60 percent of this year's surveyed agreements, and the percentage of agreements containing MAC exceptions for changes in political conditions and international calamities also rose, 14 percent and 6 percent, respectively. These dramatic increases may be due to some combination of geopolitical and public health disaster concerns—including the growing unease with continued hostilities in Iraq and the Middle East, continued trepidation resulting from the September 11, 2001, World Trade Center and July 7, 2005, London Underground attacks; worries about impending warfare; in Iran and even the threat of pandemic spread of infectious diseases such as SARS and Avian influenza virus.

Another trend that continued from last year was an increase in agreements containing exceptions for changes caused by acts of God (as before, we have tabulated events of weather and natural disasters in the "acts of God" category). Last year, 10 percent of agreements reviewed contained a MAC exception for events of weather and other acts of God, compared to this year, where it appeared in 23 percent of the agreements surveyed. These increases may reflect heightened concerns in the wake of recent catastrophic weather events, such as the Southeast Asia tsunami in 2004 and Hurricane Katrina in 2005.

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



### MAC Exceptions: Hostilities, Calamities and Acts of God



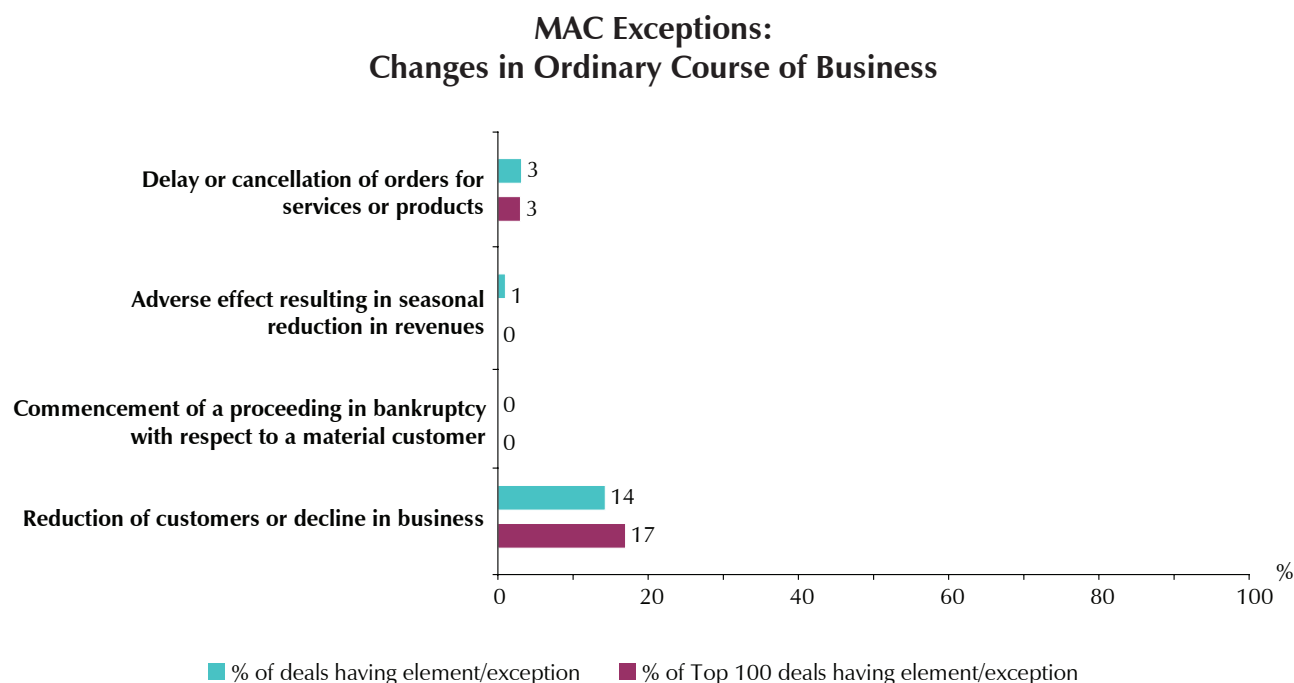
# Conclusions

## Conclusions and notable comparisons with the top 100

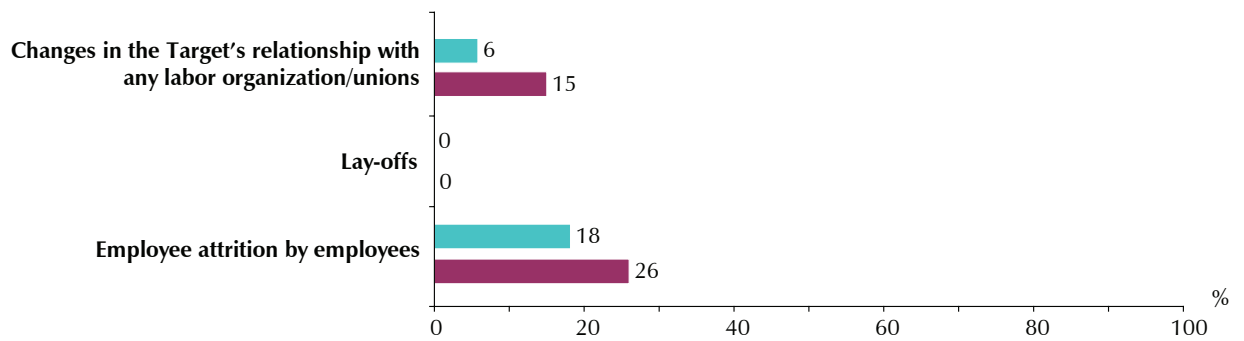
Generally, MAC exceptions appeared with slightly greater frequency within the top 100 deals in comparison to total deals surveyed, indicating that sellers have slightly greater negotiating power in larger transactions. This observation is a continuation of last year's trend. Notable examples of this trend are MAC exceptions relating to legal developments as noted above. Other exceptions such as "acts of terrorism," "acts of war," and "acts of God" appeared about 20 percent more often in the top 100 deals in comparison to total deals surveyed.

Additionally, MAC exceptions appeared with greater frequency when compared to last year's top 100 reviewed deals, suggesting that the acquisition climate remains increasingly seller friendly, especially for deals greater than \$1 billion. Overall, we again found a trend toward more seller friendly terms, particularly in the largest transactions — a continuation of our observations from last year. The outcome of the current credit crisis will influence whether this trend will continue in the large deal market.

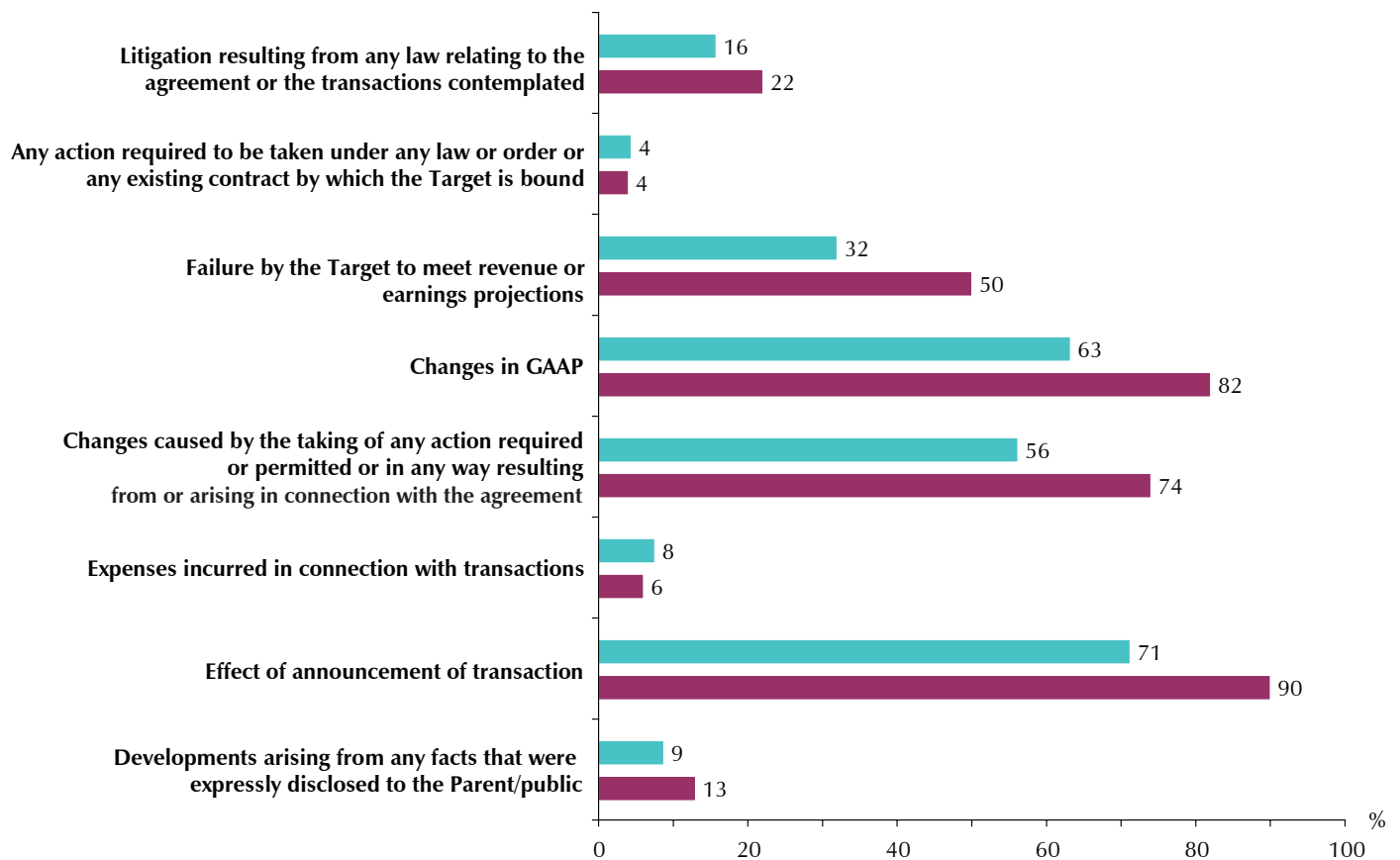
The following chart shows the remaining results of our survey:



### MAC Exceptions: Employee Matters



### MAC Exceptions: Miscellaneous



■ % of deals having element/exception ■ % of Top 100 deals having element/exception

Nixon Peabody LLP is one of the largest law firms in the United States with more than 700 attorneys collaborating across 25 major practice areas in 17 office locations, including Boston, Chicago, London, Los Angeles, New York, San Francisco, Silicon Valley and Washington, D.C.

### **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 a 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.

### **Private Equity**

Nixon Peabody provides strategic advice and legal counsel to private equity, distressed and venture capital funds, hedge funds, portfolio companies and institutional investors. Services include leveraged buyouts, control and non-control investments, business combinations, growth financings, joint ventures and other strategic transactions.

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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