

MAC SURVEY NP 2019 REPORT



**NIXON
PEABODY**



17TH

Study of current
negotiation trends
involving material
adverse change clauses
in M&A transactions

Contents

Introduction	3
Our Methodology	3
Summary of Results	4
Charts:	
MAC ELEMENTS	5
MAC ELEMENTS: DEFINITIONAL MATTERS	6
MAC EXCEPTIONS: CHANGES IN MARKETS	8
MAC EXCEPTIONS: HOSTILITIES, CALAMITIES, AND ACTS OF GOD	10
MAC EXCEPTIONS: LEGAL DEVELOPMENTS	11
MAC EXCEPTIONS: EMPLOYEE MATTERS	12
MAC EXCEPTIONS: CHANGES IN ORDINARY COURSE OF BUSINESS	12
MAC EXCEPTIONS: MISCELLANEOUS	13
Conclusions.....	15

We are pleased to present the findings from our 17th MAC Survey

The mergers and acquisitions environment has remained robust since our last survey. 2018 was the third highest year ever for M&A volume, and while we have seen fewer deals announced in 2019 than in prior years, **the size of the announced deals has been significant.** Contributing to this overall trend were a number of strategic **multi-billion dollar megadeals** in industries such as **software, energy, and biopharmaceuticals.** In October 2018, **IBM Corporation** agreed to acquire technology company Red Hat for \$34 billion, in a move to become a leader in the growing market for open-source software. In January 2019, pharmaceutical giant **Bristol-Myers Squibb** announced that it would acquire biotechnology company Celgene Corporation for \$74 billion, in what is considered the largest health care deal of all time. And in May 2019, after a much publicized bidding war, **Occidental Petroleum** entered into an agreement to acquire rival Anadarko Petroleum, in a transaction valued at \$55 billion. Despite global economic and geopolitical uncertainty, **mergers and acquisitions continue to be a favored approach to growth,** for reasons including, in the United States, an increase in available cash due to tax reform as well as a growing need for businesses to respond to innovation and disruption in the marketplace.



Nixon Peabody's annual analysis of material adverse change clauses in acquisition agreements over the past 18 years has evinced a dealmaking climate highly sensitive to developments both in the United States and around the world. Each year, the survey provides a renewed opportunity to examine the market's responses to shifts in the myriad economic, geopolitical, and societal forces that shape the manner and environment in which transactions occur. With each survey we conduct, we capture a more robust picture of trends in M&A transactions.

Survey results provide us vivid insight into the prevailing conditions and concerns surrounding transactions. The tragic events of September 11, 2001 cast an unmistakable shadow over our inaugural survey covering deals during 2001–2002, which notably reflected the growing concern of the potential impact of terrorism on dealmaking. Ensuing years saw the world begin to adjust to a post-9/11 reality, and an increasingly stabilized economy as a consequence. A renewed sense of security helped spur growth during this period, which fostered conditions favorable to targets. The attendant trend toward an increase in MAC exceptions halted, however, once the effects of the credit crisis and the Great Recession began to take hold in 2008 and 2009. Fewer companies found themselves in a position to buy during this time, so those that did wielded greater power in transactional negotiations. We have seen an increase in MAC exceptions in the years since the recession, indicating that the balance between purchasers and targets has equalized to some extent. Similar to the last survey we published in 2017, this year's results indicate an overall acceptance of the concept that MAC clauses should exclude from their reach general business risk.

The statistics contained in this summary convey useful information for understanding contemporary M&A transactions. Delving deeper into the results in order to explore the underlying factors influencing the results generates even more valuable knowledge. We hope that our survey and analysis of its results lead to a greater understanding of today's dealmaking landscape.

An Introduction to the MAC Clause

Material adverse change or material adverse effect clauses, often referred to as MAC or MAE clauses, serve dual purposes. First, a MAC definition is used in qualifications to various representations, warranties, and covenants, establishing a threshold for determining the scope of disclosure or compliance relating to risks associated with the changes in the target's business. For example, a representation may provide that a target has complied with all cybersecurity laws and directives "except as would not have a Material Adverse Effect." Such a MAC qualification would allow, for example, an immaterial breach of a cybersecurity law or directive to have a significantly reduced effect on the consummation of a deal.

As a second function, the MAC clause is used to delineate the circumstances under which a bidder would be permitted to exit a transaction without liability. This right to walk away is frequently referred to as a "MAC out" and generally appears in the conditions precedent to the bidder's obligation to close the deal. A typical MAC-out provision states as a condition that "there shall not have occurred a Material Adverse Change in the Company." The delineated events constituting a MAC are then qualified by a listing of other events, often referred to as "MAC exceptions." MAC exceptions preclude bidders from walking away from a deal or seeking a renegotiation of material terms on the basis that a MAC has taken place. The delineated events constituting a MAC, together with MAC exceptions, allocate carefully calibrated and negotiated deal certainty risk and risk of loss between the bidder and the target that may result from adverse circumstances occurring in the target's business in the sensitive period between deal execution and completion.

MAC clauses are often heavily negotiated between the parties. A target usually attempts to narrow the MAC definitional elements and expand the exceptions in order to shift risk to the bidder. By shifting risk to the bidder, the target bolsters the certainty of the deal's closing and its ability to preserve deal pricing. Bidders, however, strive to shift the risk to

the target by expanding MAC elements and reducing the number and scope of the exceptions allowed, thereby reserving for the bidder a greater ability to walk away from the deal or to renegotiate deal terms. While courts generally are reluctant to enforce MAC clauses, in 2018, the Delaware Chancery Court held that a target company's sustained drop in business performance between signing and closing constituted a MAC, and that its breach of representations regarding regulatory compliance would be expected to result in a MAC, allowing the buyer in that case to terminate the merger agreement. In addition, in recent years, some bidders have successfully invoked MAC provisions in order to re-price a deal.

Our Methodology

As with our prior surveys, we reviewed publicly filed acquisition agreements for transactions with values in excess of \$100 million dated between June 1 of the preceding year and May 31 of the current year. For this survey, we collected a sizable sampling of deals executed between June 1, 2018, and May 31, 2019, from publicly available information filed with the U.S. Securities and Exchange Commission. This year, we reviewed 200 agreements, which included asset purchase, stock purchase, and merger agreements. The surveyed transactions represent an expansive array of industries and range in value from \$100 million to over \$74 billion. While we note that our review and analysis are not technically scientific and do not include private transactions for which no agreement is publicly available, we believe that the results generally reflect the climate of M&A transactions during the period.

Furthermore, we analyzed the 78 deals in our sample valued at \$1 billion or more, comparing them to all deals reviewed during the period examined; we believe this may shed light on some differences between the largest deals and their middle-market counterparts.

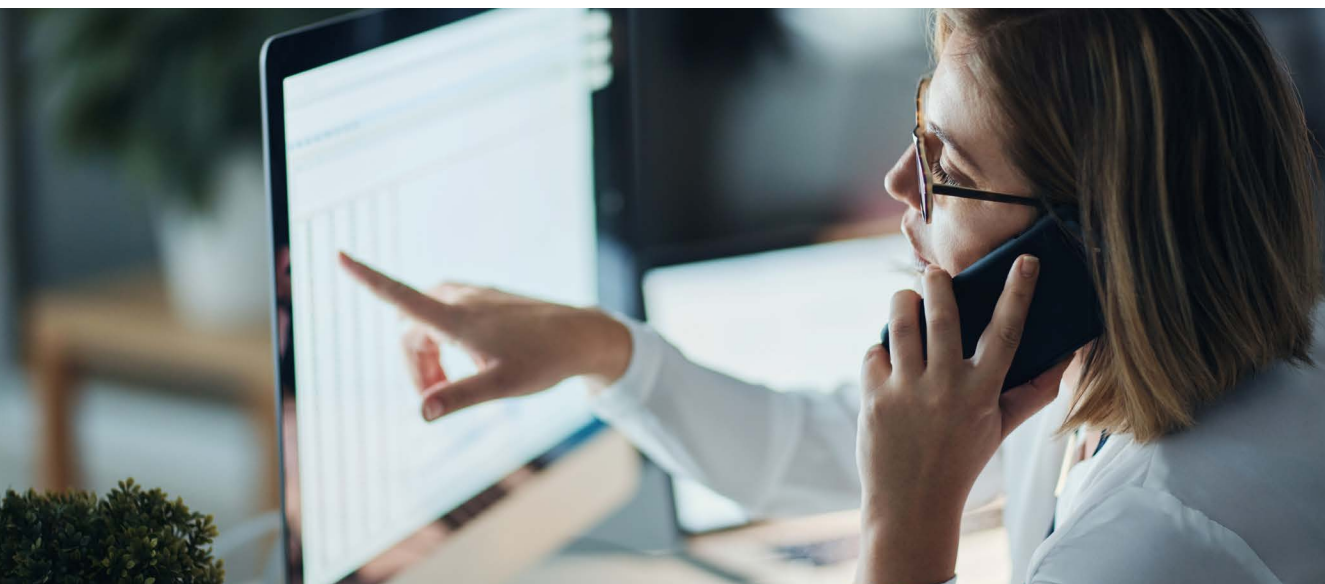
Summary of Results: Pro-Bidder Trends

Of the 200 agreements surveyed, 196 (98%) contained a material adverse change in the “business, operations, financial conditions of the Company” as a definitional element. This is an increase from the previous survey, when this element appeared in 89% of all agreements. Meanwhile, none of the 200 acquisition agreements reviewed this year lacked a MAC closing condition, compared to 7% reported in the 2017 survey and 3% reported in the 2016 survey. These trends demonstrate the universal acceptance of MAC clauses in M&A documents.

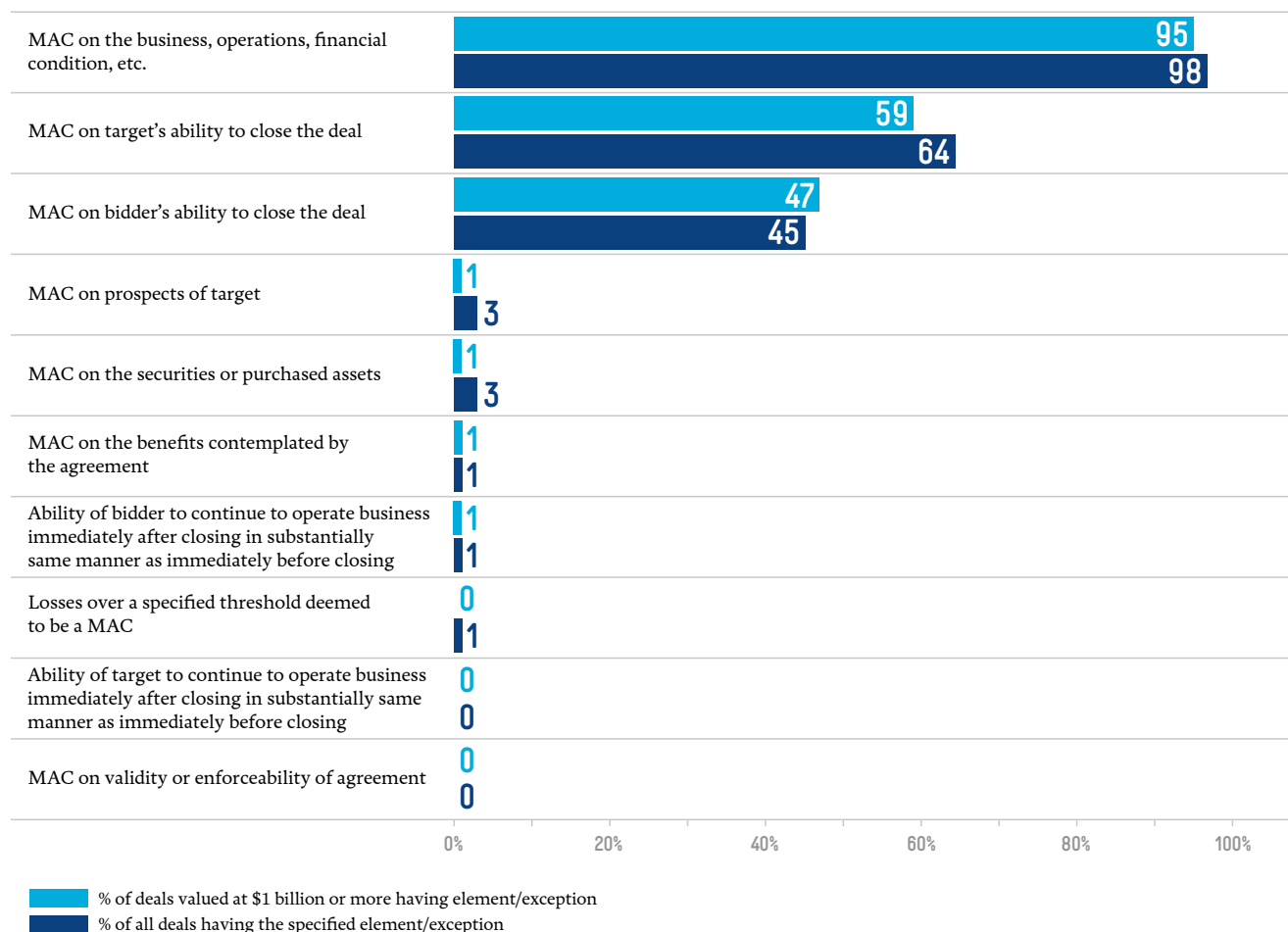
This year’s results indicate a continuing shift toward a more objective test in determining whether a change constitutes a MAC. More agreements contained the pro-bidder “would reasonably be expected to” language in the MAC definition—it appeared in 74% of the deals reviewed this year, while appearing in 62% of all deals reviewed in 2017. This language appeared in 54% of all deals reviewed in 2016, 61% of deals reviewed in 2015, 56% in 2014, 53% in 2013, 42% in 2012, and just 29% in 2011. By defining a material adverse effect to involve circumstances that “would reasonably be expected to” lead to a MAC, a bidder introduces a forward-looking feature to the definition, allowing it to adopt a more lenient approach during negotiations over whether a material adverse change in the target’s prospects needs to be covered by the definition.

We also saw an increase in the usage of pro-bidder “disproportionately affect” language in the MAC exceptions during this year’s surveyed period. Such language appeared in 87% of the deals reviewed this year, while appearing in 76% of deals reviewed in 2017 and 81% and 83% of deals reviewed the two years before—which evidenced a significant increase over the 73% found in our 2011 and 2012 surveys and the 48% and 40% found in our 2009 and 2010 surveys, respectively. “Disproportionately affect” language carves out exceptions from the MAC clause to ensure that bidders have the protections of the MAC clause in the event the target company suffers more greatly than its peers from a specified event, such as a general economic or industry downturn. We are optimistic that the increase in the use of “disproportionately affect” clauses reflects the continued maturation and uniformity of MAC provisions generally.

The chart on the next page details the prevalence of MAC elements in our survey.



MAC ELEMENTS



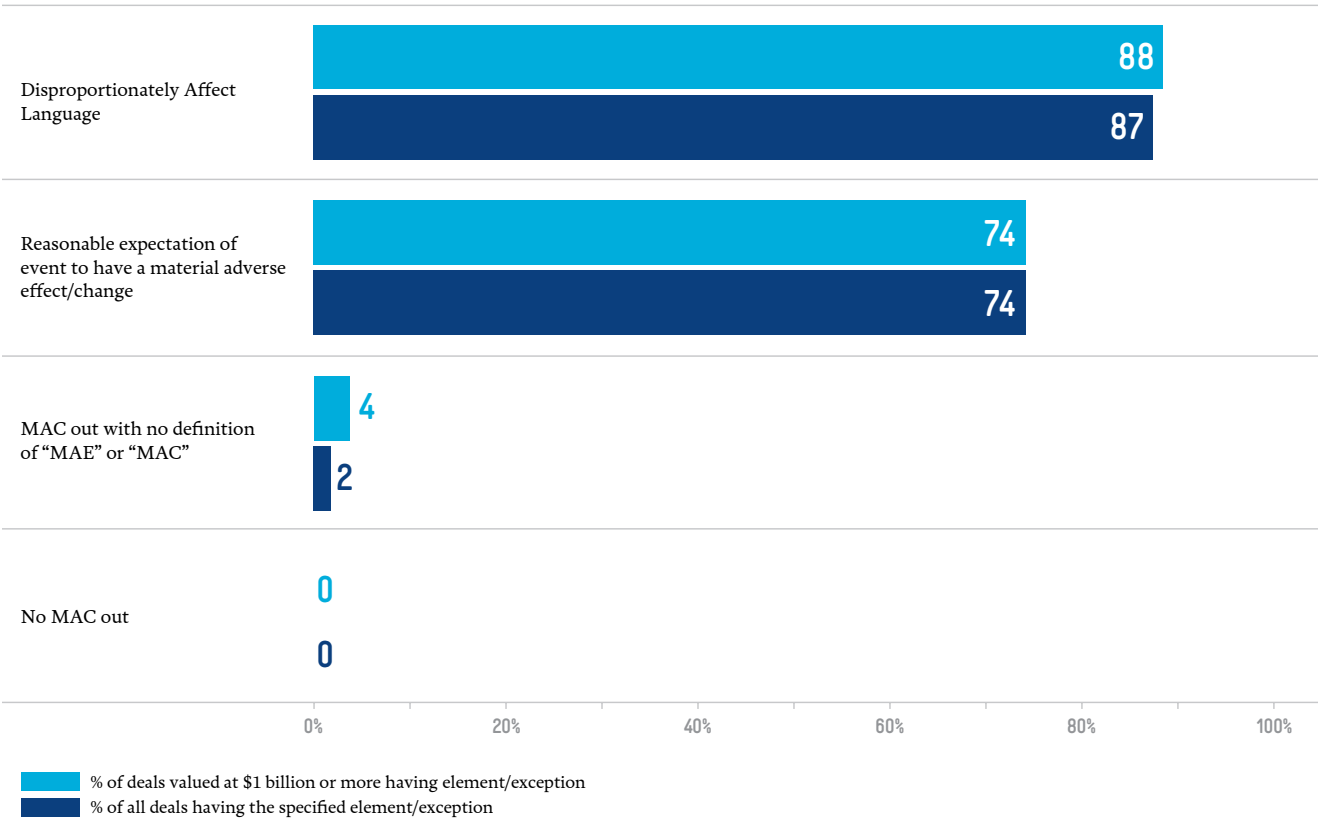
Increase in “Would Reasonably Be Expected to” Language in the MAC Definitions, Particularly in the Largest Deals

The MAC formulation where a listed event “would reasonably be expected to” result in a material adverse effect broadens the scope of events qualifying as materially adverse by allowing the bidder to account for effects on the target that are foreseeable but not yet revealed on an income statement or balance sheet. This clause incorporates a prospective element into the MAC clause formulation, significantly advantaging bidders. For example, notification from a

target’s major customer that it would no longer do business with the target “would reasonably be expected to” result in a loss of sales and a decline in profits but those effects may not have occurred by closing. In 2019, the “would reasonably be expected to” formulation increased from previous years, appearing in 74% of all deals reviewed, compared to 62% in 2017, 54% in 2016, 61% in 2015, 56% in 2014, 53% in 2013, and 42% in 2012. In addition to appearing in 74% of all agreements reviewed, this year, the formulation appeared in 77% of deals valued at \$1 billion or more.

The chart below details the findings in our survey with respect to general definitional matters.

MAC ELEMENTS: DEFINITIONAL MATTERS



Appearance of “Disproportionately Affects” Language Limiting the Exclusions Remains High

The pro-bidder “disproportionately affects” qualification ensures that exclusions favoring the target apply only when the target is keeping pace with its peers and its industry, not when it is an outlier in terms of its vulnerability to systemic threats. In about 87% of the agreements reviewed this year (and in approximately 88% of deals valued at \$1 billion or more), the exclusions were limited in whole or in part to specified events that did not “disproportionately affect” the target. The use of the qualification increased slightly from the previous two years in which we conducted the MAC Survey, when it appeared in 76% and 81% of the agreements surveyed in 2017 and 2016, respectively. The increasing acceptance of this clause indicates that bidders and targets almost always reach consensus on the appropriate limits of exclusions from the MAC definition for factors affecting the target and its peer companies generally that typically are outside the control of the target.

More MAC Exceptions for the Largest Deals; Uniformity Across Industries

MAC exceptions tend to appear with greater frequency in the 78 deals valued at \$1 billion or more, compared to the full sample of 200 deals for the period covered in this survey. We identified, on average, approximately 14.1 exceptions per agreement for all agreements reviewed and about 15.3 exceptions per agreement for the top 78. It would appear that the MAC clauses in deals valued in the billions of dollars are more stringently negotiated, and this is reflected in the number of MAC exceptions and the length of the MAC clause in general. This approach reflects the heightened importance of carefully delineating material events that could threaten deal certainty in the largest transactions.

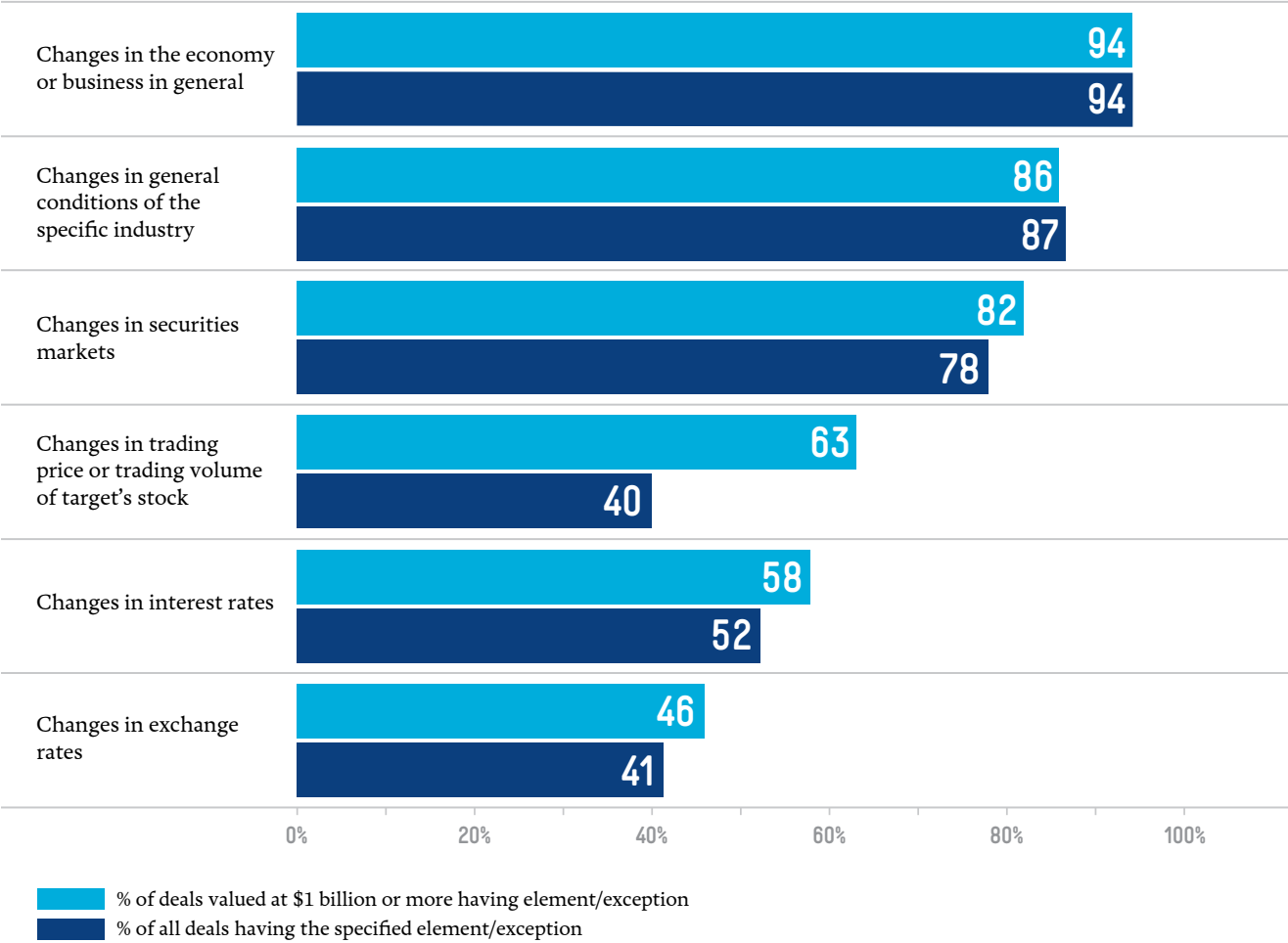
Among deals of the same magnitude, we observed a similar frequency of MAC exceptions across different industries, which reflects a relatively developed uniformity in MAC clauses. This is perhaps a sign of risk-averse approaches by both bidders and targets, as both sides may prefer conforming MAC clauses to market standards over negotiating unique formulations, particularly in the current competitive bidding and time compressed environment for M&A transactions. It also may signal a greater common understanding of the meaning of a material adverse change.

Exceptions Related to Changes in the Economy

In our previous survey, MAC exceptions for “changes in the economy or business in general” and “changes in general conditions of the specific industry” appeared in 85% and 80% of transaction agreements reviewed, respectively. This year, these exceptions increased to 94% and 87%, respectively, of transaction agreements reviewed. The MAC exception for “change in trading price or trading volume of Company’s stock” appeared in 40% of deals, a slight increase from its 2017 level of 36%. We note also that the exception for “change in trading price or trading volume” appeared in 63% of the 78 deals surveyed this year that were valued at \$1 billion or more, reflecting the increased significance of trading price fluctuations on the larger transactions, which largely tend to involve public company acquisitions. The MAC exception relating to a change in securities markets appeared in 78% of deals this year, an increase from its 2017 level of 70% but still down from 82% in 2016.

The chart on the next page details the prevalence of MAC exceptions found in our survey relating to “Changes in Markets.”

MAC EXCEPTIONS: CHANGES IN MARKETS





Exceptions for Changes Resulting from Acts of Terrorism and Changes in Political Conditions

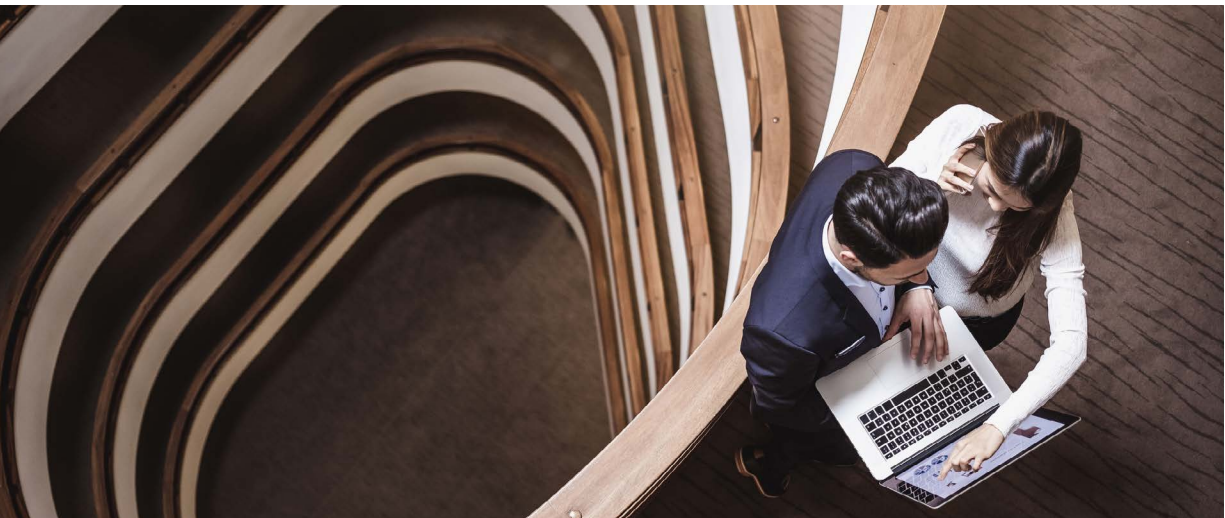
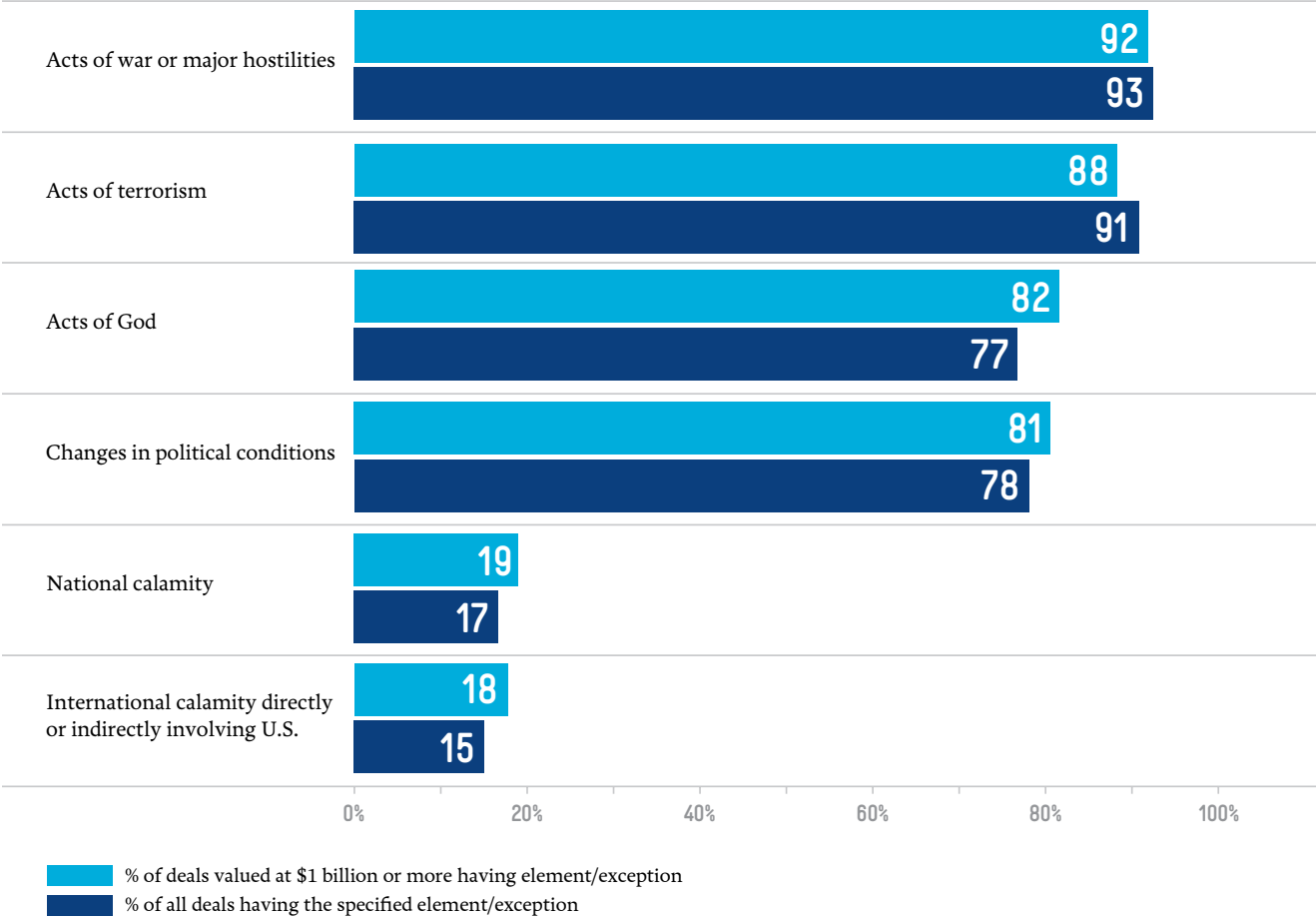
This year's survey featured overall increases from the 2017 survey in MAC exceptions for changes resulting from acts of war, acts of terrorism, political conditions, and acts of God:

- “Changes due to acts of war or major hostilities” appeared in 93% of the agreements reviewed this year, an increase from 81% of agreements reviewed in 2017 and 85% in 2016. This exception appeared in 82% of agreements surveyed in 2015, 85% in 2014, 88% in 2013, and 74% of those in 2012 and 2011.
- “Changes due to acts of terrorism in the United States or abroad” appeared in 91% of the agreements reviewed this year, an increase from 80% of agreements reviewed in 2017 and 85% in 2016. This exception appeared in 82% of the agreements surveyed in 2015, 85% in 2014, 87% in 2013, and 67% in 2012.
- “Changes in political conditions” appeared in 78% of the agreements surveyed this year, a slight increase from the 71% and 73% of agreements surveyed in 2017 and 2016, respectively, and up from 66% in 2015 and 67% in 2014. This exception appeared in 82% of the 78 deals valued at \$1 billion or more, a decrease from the previous survey's 86%.

- The “acts of God” exception appeared in 77% of the agreements reviewed this year, compared to 66% in 2017, 64% in 2016, 61% in 2015, 67% in 2014 and 2013, 43% in 2012, and 40% in 2011, suggesting perhaps that recent natural disasters and increased weather volatility linger in the minds of targets, bidders, and their counsel. Notably, the “acts of God” exception appeared in 82% of the agreements in our sample valued at \$1 billion or more, although this was a decrease from 93% in 2017.
- The broadly worded exception for an “international calamity” appeared more frequently in this year's survey, which could reflect increased uncertainty surrounding risks relating to global security, Brexit, international trade, and other international issues. The exception appeared in 15% of all deals surveyed this year compared to 10% in 2017, and 18% of deals valued at \$1 billion or more, compared to 14% in 2017.

The chart on the next page details the prevalence of MAC exceptions relating to changes arising from hostilities, calamities, and acts of God.

MAC EXCEPTIONS: HOSTILITIES, CALAMITIES, AND ACTS OF GOD



Exceptions Relating to Changes in Legal Developments

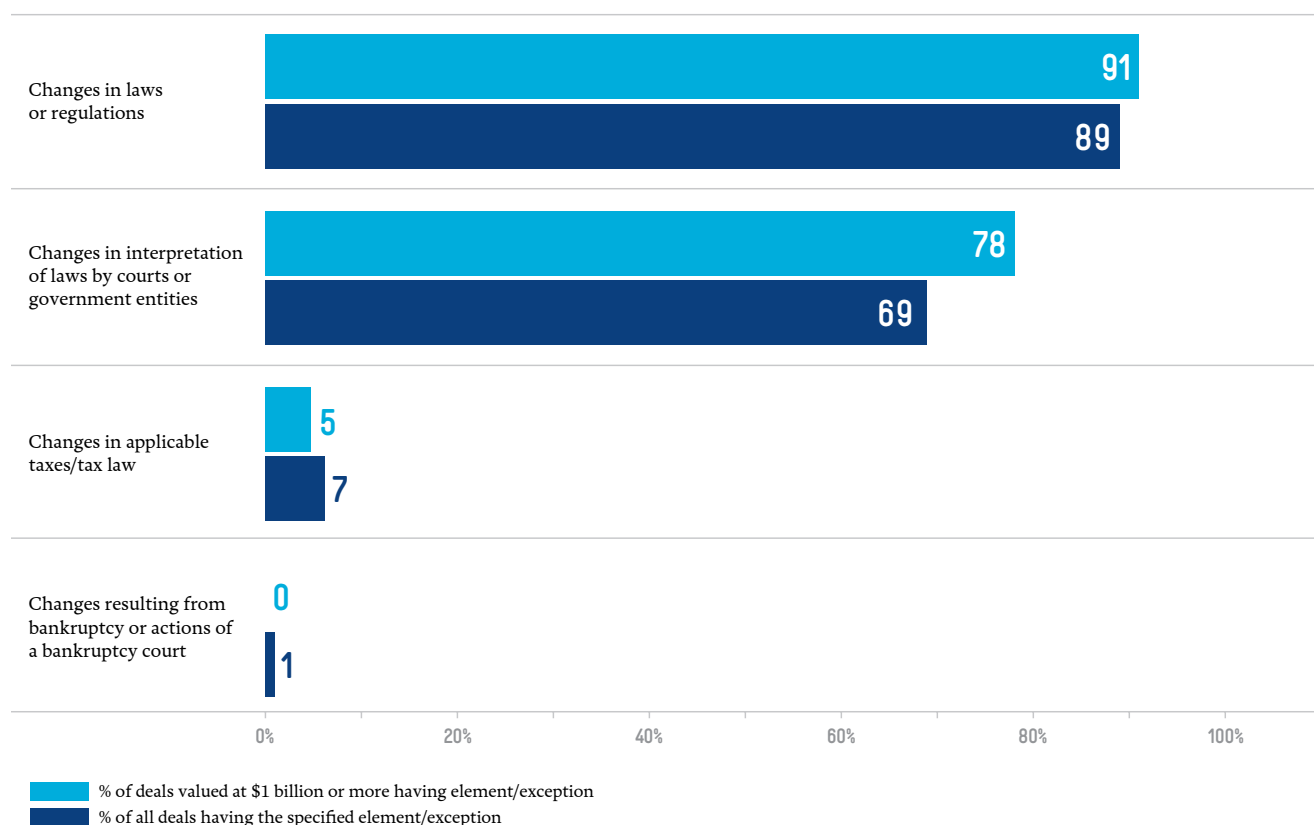
The MAC exception for “changes in laws or regulations” has grown quite steadily in the past decade. While this exception appeared in only 42% of transaction agreements in our 2006 review, this MAC exception has consistently appeared in more than 80% of the agreements reviewed in each of the last five years. The exception appeared in 83% of the agreements surveyed this year, 88% in 2016, 83% in 2015, 85% in 2014, 89% in 2013, 71% in 2012, and 67% in 2011. From our own experience, we have observed targets focusing on this exception due to continued

concerns over the United Kingdom’s plans to leave the European Union and the potential regulatory impact of the Trump administration, which may be reflected in our survey results.

The exception for “changes in interpretation of laws by courts or government entities” appeared in 57% of the deals reviewed this year, down slightly from 59% of the deals reviewed last year. This figure was at 57% in 2015, 65% in 2014, 62% in 2013, 41% in 2012, and 27% in 2011.

The chart below details the prevalence of MAC exceptions found in our survey that relate to changes in legal developments:

MAC EXCEPTIONS: LEGAL DEVELOPMENTS



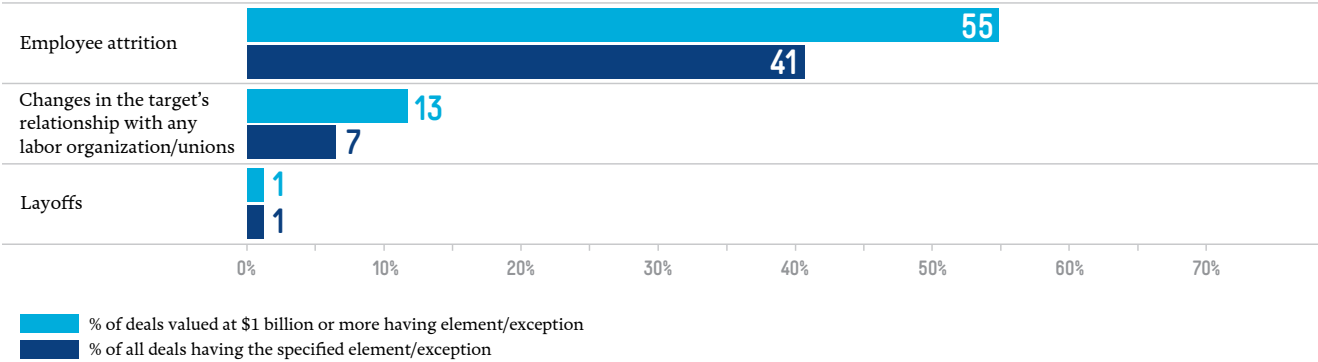
Other Notable Comparisons with the Top 78

As we observed before, MAC exceptions typically appeared at a higher rate within the 78 deals in our sample valued at \$1 billion or more, in comparison to the total deals reviewed. Notable examples include the carve-outs for changes in the economy or business in

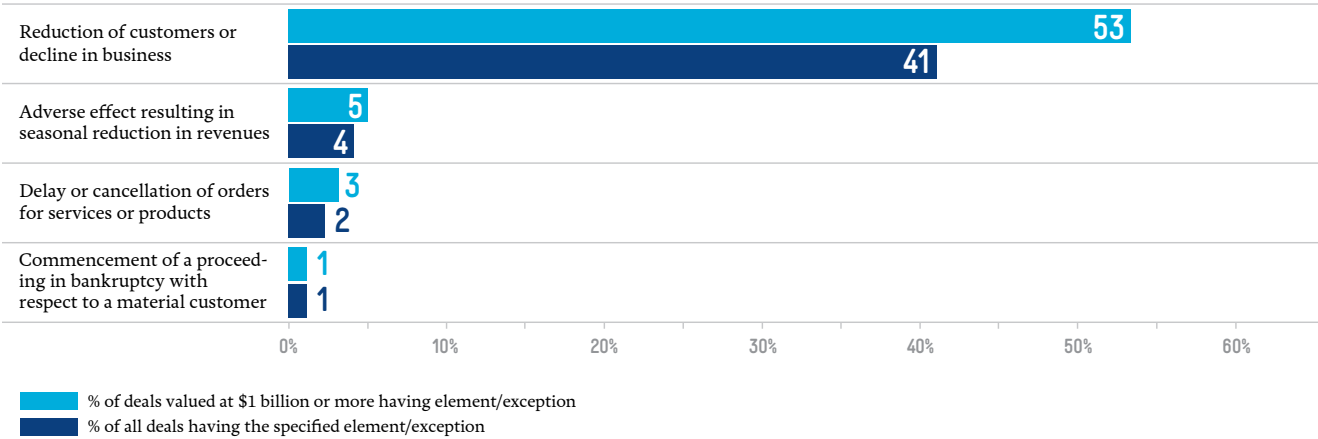
general, changes in general conditions of the specific industry, changes in trading price or volume of the target’s stock, acts of God, the effect of the announcement of the transaction, and the failure of the target to meet revenue or earnings projections.

The following charts present the remaining results of this year’s survey.

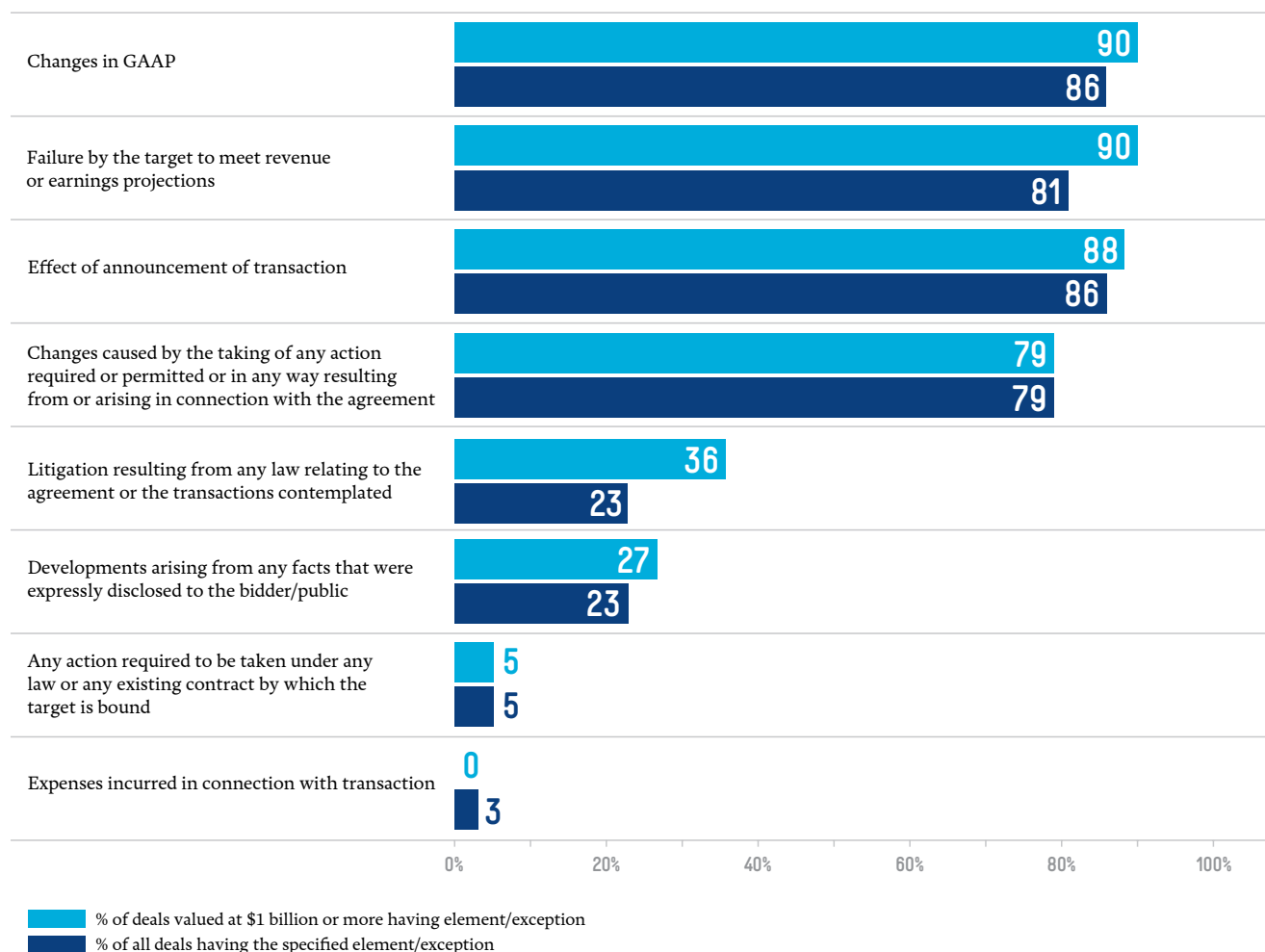
MAC EXCEPTIONS: EMPLOYEE MATTERS



MAC EXCEPTIONS: CHANGES IN ORDINARY COURSE OF BUSINESS



MAC EXCEPTIONS: MISCELLANEOUS





Akorn and Other Recent MAC Cases

Although court decisions have indicated that enforcement of MAC clauses is generally difficult, in October 2018, the Delaware Chancery Court decided for the first time that a MAC had occurred that permitted a buyer to walk away from a merger. In *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325 (Ch. Oct. 1, 2018), the court held, among other things, that (1) target company Akorn's sudden and sustained drop in business performance constituted a MAC, and (2) that Akorn's representations regarding regulatory compliance were not true and correct, and that this deviation would reasonably be expected to result in a MAC. As a result, the court concluded that the bidder, Fresenius, validly terminated the deal. The case involved some unusual facts: a long (up to one year) period between signing and closing due to antitrust concerns; an 86% decline in full-year EBITDA and a 51% decline in adjusted EBITDA; and serious and pervasive data integrity and compliance problems brought to light by whistleblower complaints.

The 247-page opinion (which also cited our 2017 MAC Survey) cited and quoted extensively from the two leading Delaware decisions that declined to find a MAC: *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008) and *In re: IBP Shareholders' Litigation*, 789 A.2d 14 (Del. Ch. 2001). The court began its analysis with cautionary language from each of those opinions that the party claiming a MAC bears a "heavy burden" and that "a short-term hiccup" should not suffice, but, rather, the impact must be consequential to the company's long-term earnings power and durationally significant when measured over a "commercially reasonable period, which one would expect to be measured in years rather than months" (citing *Hexion*). Thus, it will remain a "heavy burden" to demonstrate a MAC. Detailed precedent involving MAC clauses remains sparse, and so it is wise to incorporate in deal agreements thoughtfully prepared MAC language.

Bidders also have had some success invoking MAC clauses to renegotiate deal terms in their favor. In one such example, health care company Abbott Laboratories sued to enforce in its capacity as the

bidder, the MAC clause in its merger agreement with target company Alere Inc. after finding that Alere was under a number of government investigations and had been delisted by the New York Stock Exchange, among other issues. In April 2017, the parties settled on a purchase price of \$5.3 billion, less than the originally agreed-upon \$5.8 billion. Even when case law favors targets, targets are at times willing to settle by making a purchase price adjustment, rather than risk costly litigation and the possibility that the deal will not close.

MAC Clauses: Conclusions

Despite the economy's continued stability, caution and an ever-present concern for unforeseeable changes seem to have inspired nearly all sizable M&A transactions to include detailed MAC clauses. While the economy has shown many signs of marked improvement in the intervening years, the continued widespread inclusion of elaborate MAC clauses in these agreements suggests that these complex clauses now have become a permanent fixture in M&A deals. This year, we continue to observe in MAC clauses an awareness of geopolitical and legal developments as they affect deals. Global economic uncertainty, global security concerns, Brexit risks, trade tensions, and changing regulations on foreign investment are all likely to affect the way bidders and targets allocate risk.

Nixon Peabody will continue to closely monitor how the dealmaking market responds to these, and other, developments in the years to come.

For more information on MAC provisions, please contact your Nixon Peabody attorney or one of the attorneys listed at the end of this report.



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Chambers USA regularly recognizes Nixon Peabody as a “Highly Regarded” firm for Corporate/M&A in its guide, *America’s Leading Lawyers for Business*. The firm has been recognized by the Association for Corporate Growth and *M&A Advisor* as the legal advisor of the “Middle Market Deal of the Year” as well as the “Cross-Border Deal of the Year.” *U.S. News and World Report* regularly ranks our corporate law practice as a national Tier 1 leader and has named us “Law Firm of the Year” in health care law. In addition, *American Lawyer* has featured our firm on the cover of its “Dealmakers of the Year” issue for our work in advising one of the most complex and groundbreaking transactions.

Our annual surveys give us keen insights about deal terms and conditions that our clients rely upon to optimize their transactions. We devise innovative solutions for overcoming the challenges and issues that may arise, resulting in transactions that are quicker, smoother, and cost-efficient.

About Nixon Peabody

Nixon Peabody LLP helps clients navigate complex challenges in litigation, real estate, and corporate and finance law. With more than 600 attorneys throughout the United States, Asia, and Europe, our firm works collaboratively to serve clients ranging from large corporations and financial institutions to start-ups, entrepreneurs, and private individuals. Employing innovative and client-centered approaches, our attorneys help to anticipate and capture opportunities, prepare for and manage risks, protect intellectual property, and forecast and overcome obstacles.

At Nixon Peabody, we are committed to the clients we serve, the communities in which we serve them, and the diverse professionals who have helped make us a “Best Law Firm.”

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