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Drafting Considerations from the MAC Decision

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Editor's note: Gail Weinstein is senior counsel, and Steven Epstein and Matthew V. Soran are partners at Fried, Frank, Harris, Shriver & Jacobson LLP. This post is based on a Fried Frank memorandum by Ms. Weinstein, Mr. Epstein, Mr. Soran, Robert C. Schwenkel, David L. Shaw, and Andrew J. Colosimo, and is part of the Delaware law series; links to other posts in the series are available here. Related research from the Program on Corporate Governance includes Allocating Risk Through Contract: Evidence from M&A and Policy Implications (discussed on the Forum here) and M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice, both by John C. Coates, IV.

In *Akorn v. Fresenius* (Oct. 1, 2018), the Delaware Court of Chancery found for the first time ever that a target company had suffered a "material adverse effect" (MAC) between the signing and closing of a merger agreement, which entitled the acquiror to terminate the agreement. The 246-page opinion by Vice Chancellor Laster also serves essentially as a primer on how the court may interpret certain standard provisions in merger agreements and in corporate contracts generally.

Below, we provide (i) a summary of Key Points relating to the decision; (ii) a summary of the factual background and the court's holdings; and (iii) a review of the court's discussion of various agreement provisions. We also offer practice points, including specific drafting considerations, that arise from the opinion. We note that the decision is being appealed, thus further explication of these issues may follow.

Key Points

The court emphasized a strongly contractarian approach. Throughout the opinion, the court emphasized that, given that Delaware is a "contractarian" jurisdiction, it will rely on the specific words of the merger agreement and will not "read in" concepts that the parties did not specifically provide for. The decision thus underscores the importance of ensuring that merger agreement provisions as drafted accurately reflect the parties' business understandings. Further, the decision highlights the need for any special issues or concerns relating to the company, the business, the industry or the transaction to be expressly and specifically dealt with in the agreement. In finding that the acquiror had been entitled to terminate the merger agreement, the court stated that, notwithstanding the parties' mutual commitment to use reasonable best efforts to consummate the transaction, "they were not committing themselves to merge at all costs and on any terms. Instead, they were committing themselves to fulfill the contract they had signed…which gave each of them the right to terminate under certain specified circumstances."

MAC—The court found, for the first time ever, that a MAC occurred, permitting an acquiror to terminate a merger agreement. The court applied the traditional Delaware framework for evaluating, under a typical MAC clause, whether a MAC had occurred—that is, whether the changes that occurred represented, from the viewpoint of a reasonable long-term investor, a material decline in the earnings power of the company, based on "company-specific" (rather than "industry-wide") factors. *Importantly, the decline in this case and its "durational significance" were far more dramatic than in previous cases in which the court has evaluated whether a MAC occurred*. This suggests that it will continue to be difficult for an acquiror to establish the occurrence of a MAC. In *Akorn*, the target's financial performance "fell off a cliff" shortly after signing. Over the course of one year following the signing, EBITDA had declined 86%; analyst valuations for the company had decreased from about $32 per share to $5-12 per share; and the declines showed no sign of abating. The court (i) reiterated that there is no "bright-line test" for the occurrence of a MAC; (ii) rejected the concept that MAC clauses *implicitly* allocate to the acquiror risks "known" to the acquiror at the time of signing; and (iii) found that the emergence of new competitors for the company's top three products was a "company-specific" (rather than an "industry-wide") change.

Regulatory Compliance Representation—The court found that the target company's regulatory noncompliance itself constituted an MAE. Under the merger agreement, the failure of the regulatory compliance representation to be "true and correct" at closing, to the extent of an MAE, provided a second, independent ground for the acquiror's termination of the agreement (in addition to the "general MAC" based on financial performance, noted above). The court found that remediating the regulatory noncompliance would take several years, would cost the equivalent of 21% of Akorn's market capitalization, and would have lasting "qualitative" effects.

Ordinary Course Covenant—The court found that the target materially breached its covenant to operate in the ordinary course of business pending closing—based on what would be expected of a "generic pharmaceutical company." The court ruled that the acquiror had a third, independent basis on which to terminate the merger agreement, which was that the target had breached its covenant to use commercially reasonable efforts to operate in the ordinary course of business in all material respects between signing and closing. Citing the target's decisions that led to serious regulatory noncompliance and its failures to remedy the noncompliance, the court viewed the target as having "chose[n] consciously to depart from *the ordinary course of business that a generic pharmaceutical company would follow*" (emphasis added). The breaches of the covenant were material, the court held, as the target's actions "departed from what Fresenius could reasonably expect and changed the calculus of the acquisition for purposes of closing."

The overall factual context included the target company engaging in fraudulent misconduct while the acquiror made diligent efforts to close (even while the acquiror evaluated whether it had the right to terminate the agreement). The court viewed the target company as having fraudulently misled both the acquiror and the target's primary regulator (the FDA) with respect to its regulatory noncompliance—while the acquiror diligently moved toward closing, even as material problems surfaced and the acquiror was evaluating whether it had a right to terminate. The decision underscores the benefit of an acquiror's continuing to fulfill its contractual obligations (including to use efforts to "problem-solve" and to close) even after problems develop and while evaluating whether there is a right to terminate.

The court commented on a number of other standard phrases and provisions in the merger agreement, including the following:

- ***Materiality standards for compliance with a covenant***. The court viewed the standard requirement of compliance with a covenant "in all material respects" as imposing a lower materiality standard than compliance subject to an MAE qualification. The decision thus highlights that a target's failing to respond reasonably to a development between signing and closing not only may implicate the MAC condition but might (even in the absence of a MAC or MAE) constitute a breach of the ordinary course covenant.
- ***Efforts standards***. The court indicated that "reasonable best efforts" and "commercially reasonable efforts" standards are used interchangeably and, for practical purposes, impose the same obligation—namely, to take all reasonable steps to problem-solve and to consummate the transaction. The court appeared to indicate that "best efforts" may represent a higher standard than these, but observed that it is still "implicitly qualified by a reasonableness test—it cannot mean everything possible under the sun."
- ***Utilizing an access right to investigate a right to terminate***. The court ruled that the acquiror's wide-ranging investigation of the target's regulatory compliance issues (after it had received two detailed whistleblower letters) was a proper use of its access right and did not violate its obligation under a nondisclosure agreement to use confidential target information only for the purpose of consummating the transaction.
- ***Potential tension between a hell-or-high-water commitment to obtain antitrust clearance and a right to control the strategy for obtaining the clearance***. The court ruled that the acquiror "technically" breached its unconditional hell-or-high water covenant to obtain antitrust clearance. Specifically, the acquiror decided to change its divestiture strategy; and the new strategy was expected to extend by two months the date on which the clearance would be obtained (a date that was still well before the drop-dead date).The breach was not "material," however, the court ruled, because the acquiror reverted to the original divestiture strategy within a week and the week delay was not expected to have any effect on the timing of obtaining clearance. (We note that there was evidence in the record that indicated that the acquiror's change in strategy might have been for the purpose of obtaining more time to evaluate whether there had been a MAC or an MAE.)
- ***No implicit opportunity to cure until the drop-dead date***. The target argued that the acquiror could not terminate the agreement before the drop-dead date because the agreement provided that the target had the right to an opportunity to cure breaches. Focusing on the agreement language, the court observed that the opportunity to cure was subject to the breach "being curable" by the drop-dead date. In this case, the target itself estimated that it would take three years to cure the regulatory problems underlying the breach (which was far beyond the drop-dead date). Therefore, the court ruled that the acquiror could terminate the agreement without providing an opportunity to cure.

Factual Background, the Merger Agreement and the Court's Holdings

Factual Background. Fresenius Kabi AB, a Germany-based pharmaceutical company, terminated the merger agreement pursuant to which it was to acquire Akorn, Inc., a US-based generic drug manufacturer, for $34 per share (a $5.8B deal). The termination followed a dramatic decline in Akorn's performance that started shortly after signing. Both parties attributed the decline to "the unexpected entry of new market participants for [Akorn]'s top three products" and the related “price erosion.” The court held that Fresenius had the right to terminate the merger agreement. Akorn has announced that it will appeal.

The Merger Agreement. The agreement contained standard provisions, which were well-drafted and detailed. Both parties had eminent legal counsel. The agreement provided as follows:

- ***Standalone MAC Condition***. Closing was conditioned on there not being a Material Adverse Change (MAC) in the target company between signing and closing (the “General MAC Condition”). The detailed definition of a “MAC” excluded changes reflecting industry-wide conditions, but excepted from that exclusion industry-wide conditions that had a disproportionate effect on the target.
- ***Bring-Down Condition***. Closing was conditioned on the target’s representations being true and correct as of the closing date, except where the deviation between the as-represented condition and the actual condition of the company would not reasonably be expected to lead to a Material Adverse Effect (MAE) (the “Bring-Down Condition”). The key representation at issue was that the target was in compliance in all material respects with regulatory requirements (the “Regulatory Compliance Representation”).
- ***Covenants Condition***. Closing was conditioned on the target having complied in all material respects with its obligations under the agreement (the “Covenants Compliance Condition”).
- ***Hell-or-High-Water Commitment to Obtain Regulatory Approval***. The acquiror agreed (without any qualification as to a specified efforts standard) to “take all actions necessary” to obtain regulatory approval and not to take any action that could reasonably be expected to delay obtaining regulatory approval (the “Hell-or-High-Water Regulatory Commitment”). The agreement also provided that the acquiror would “control the strategy for obtaining any approvals” and “control the overall development of the positions to be taken and the regulatory actions to be requested….”
- ***Reasonable Best Efforts Commitment to Close***. Both parties agreed to use “reasonable best efforts to satisfy the conditions to closing as promptly as reasonably possible and to consummate [the merger]” (the “Reasonable Best Efforts to Close Commitment”).
- ***Ordinary Course Covenant***. The target agreed to “use its commercially reasonable efforts to carry on its business in all material respects in the ordinary course of business” between signing and closing (the “Ordinary Course Covenant”).
- ***Outside Date***. The parties specified an outside date for closing that was one year after the signing date (the “Outside Date”). The Outside Date would be automatically extended for three months if the only condition not then satisfied was obtaining regulatory approval.
- ***Termination***. The acquiror had the right to terminate the agreement in the event of a failure of the General MAC Condition, the Bring-Down Condition or the Covenants Compliance Condition, but only if (a) the failure was not curable by the Outside Date and (b) the acquiror was not then in material breach of any of its covenants under the agreement.

The Court’s Holdings. The court held that the acquiror had the right to terminate the merger agreement on three independent bases and that the acquiror was not itself in material breach of any of its covenants under the agreement. Specifically, the court held as follows:

i. **MAC**. The target's decline in performance post-signing constituted a MAC—thus, the General MAC Condition was not satisfied.
ii. **Representation Bring-Down**. The target's Regulatory Compliance Representation was not true and correct, and the deviation between the as-represented regulatory compliance of the target and its actual condition would reasonably be expected to result in an MAE—thus, the Bring-Down Condition was not satisfied.
iii. **Ordinary Course Covenant**. The target materially breached the Ordinary Course Covenant—thus, the Covenants Compliance Condition was not satisfied.
iv. **Acquiror Was Not in Material Breach**. The acquiror "technically breached" its Hell-or-High-Water Regulatory Commitment, but the breach was not material because it was remedied within a week and did not affect the anticipated timing of receipt of regulatory approval—thus, the breach did not defeat the acquiror's right to terminate the agreement.

The Court's Analysis of the Merger Agreement Provision

Material Adverse Change Condition

Standard legal framework for the analysis. The court applied the traditional Delaware framework for analyzing, under a typical MAC clause, whether a MAC occurred—that is, whether the company's decline in performance (i) was "material," (ii) had "durational significance," and (iii) was the result of "company-specific" (rather than "industry-wide") factors. The focus, the court reaffirmed, is on whether there has been "an adverse change in the target's business that is consequential to the company's long-term earnings power"—that is, would be material when viewed from the perspective of a reasonable long-term investor.

No bright-line test as to what is a material decline in performance. The court observed that other courts have considered decreases in profits in the 40% or more range (with durational significance) as constituting a MAC; and that Chancellor Allen posited that a decline in earnings of 50% over two consecutive quarters would likely be a MAC. There is no bright-line test, however, and these precedents do not preclude that smaller percentage changes may constitute a MAC or that larger percentage changes may not constitute a MAC, the court stated. The court noted that, in *IBP*, then-Vice Chancellor (now Chief Justice) Strine was "torn" as to whether a 64% drop in quarterly earnings constituted a MAC (but ultimately held that it was not because it did not have "durational significance").

Akorn's dramatic decline in performance. At the time the merger agreement was signed, Fresenius requested that Akorn reaffirm its annual guidance, which Akorn did. But three months after signing, just after its stockholders approved the deal, Akorn announced year-over-year declines in revenue of 29%, operating income of 84%, and earnings per share of 96%. The results for the following quarter (as compared to the same quarter in the prior year) were slightly worse; and the results for the quarter after that were considerably worse—declines in revenue of 34%, operating income of 292%, and EPS of 300%. Over the course of one year following the signing, full-year EBITDA had declined by 86% (and "full-year adjusted EBITDA" by 51%). In addition, the company fell further and further behind in new product launches, with 34 having been anticipated for the year but only about 20 actually launched (resulting in $3.3M in sales from new product launches as compared to the projected $60M). (The court confirmed the commentary in *Hexion* that, for purposes of determining whether a MAC has occurred, the company's performance generally should be evaluated against its results during the same quarter or period of the prior year in order to minimize the effect of seasonal adjustments.)

When a decline may be "durationally significant." A decline in performance will not constitute a MAC unless it reflects a material decline in value of the company "over a commercially reasonable period, which one would expect to be measured in years rather than months." A "temporary hiccup in earnings" does not suffice. Akorn's "dramatic downturn" started just after the merger agreement was signed and, at the time of trial, had "persisted for a full year and show[ed] no sign of abating." Also, the court noted: "There is every reason to think that the additional competition [to which both parties attributed the decline] will persist…." The court found "additional support for the collapse in Akorn's value and its durational significance" in analyst valuations. The DCF conducted by Akorn's financial advisor in connection with the board's approval of the deal provided a midpoint valuation of $32.12 per share—but, based on the post-signing performance, analysts estimated Akorn's standalone value at between $5 and $12 per share. At the date of termination of the agreement, analysts' forward-looking estimates for 2018, 2019 and 2020 EBITDA were lower than their estimates at signing by 63-67% (while analysts' estimates for Akorn's peer companies had declined by only 11-15%). Notably, the court observed (in a footnote) that commentators have suggested that the requirement of durational significance may not apply when evaluating whether a MAC occurred in the context of a buyer who is "a financial investor with an eye to a short-term gain."

Akorn's decline was due to "company-specific" (as opposed to "industry-wide") conditions. As noted, the merger agreement excluded from the MAC definition changes due to industry-wide conditions (that is, the risk of changes reflecting industry-wide conditions was allocated to the acquiror). Akorn argued that its decline was the result of industry "headwinds," including an increase in new competitors due to the FDA's efforts to approve generic drugs. According to Akorn, Fresenius could not claim a MAC "because everyone—including Fresenius, knew about these 'industry headwinds'" and also knew that, if the headwinds were greater than expected, Akorn "would likely underperform relative to its competitors." However, the court concluded, "[u]nder the risk allocation established by the Merger Agreement…the causes of Akorn's adverse performance were actually business risks allocated to Akorn." The unexpected new market entrants who competed with Akorn's three top products "were problems specific to Akorn based on its product mix…. [T]he problems were endogenous risks specific to Akorn's business," the court wrote. Moreover, the court commented, even if (for argument's sake) these problems were industry-wide, they "disproportionately affected Akorn" and therefore, under the merger agreement, were risks allocated to Akorn. The court pointed to Akorn's far greater underperformance than its peer companies relative to consensus analyst estimates as evidence of the disproportionate effect of the problems on Akorn.

An acquiror does not implicitly accept "known risks." Akorn argued that Fresenius could not claim a MAC based on any risks that Fresenius (i) learned about in due diligence or (ii) generally was on notice about because of its industry knowledge and did not thoroughly investigate in due diligence. The court acknowledged then-Vice Chancellor Strine's observation in *IBP* that a MAC clause "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" (emphasis added). However, in Vice Chancellor Laster's view, Akorn went "too far by transforming 'unknown events' into 'known or potentially contemplated risks.'" Such a legal regime would "replace the enforcement of a bargained-for contractual provision with a tortlike concept of assumption of risk," the court wrote—"where the outcome would turn not on the contractual language, but on an ex-post sifting of what the acquiror learned or could have learned in due diligence." In this case, the court stated, the detailed MAC definition "uses exceptions and exclusions to allocate risks between the parties" and these should govern. The court noted:

> The parties could have provided as further exclusions 'certain specific matters that the seller believes will, or are likely to, occur during the anticipated pendency of the agreement,' or matters disclosed during due diligence, or even risks identified in public filings. Or the parties could have defined [a MAC] as including only unforeseeable effects, changes, events or occurrences. They did none of these things….The contractual language is forward-looking and focuses on events. It does not look backwards at the due diligence process and focus on risks.

Thus, the court concluded, whether the risk of new competition was "known" or "unexpected," it was allocated to the target under the merger agreement as it was "company-specific."

Not mere "buyer's remorse" for other reasons. Akorn tried to cast Fresenius in the mold of the buyers in *IBP* and *Hexion*, who the court viewed as using the target's declining performance as a pretext for terminating a deal that had become "unattractive" for other reasons—in other words, mere "buyer's remorse" without an underlying MAC in the target. Vice Chancellor Laster wrote: "In my view, the difference between this case and its forbearers is that the remorse was justified. In both *IBP* and *Hexion*, the buyers had second thoughts because of problems with their own businesses spurred by broader economic factors. In this case, by contrast, Fresenius responded after Akorn suffered a General [MAC] and after a legitimate investigation uncovered pervasive regulatory compliance failures."

Bring-Down of Regulatory Compliance Representation

Quantitative and qualitative significance of inaccuracies in a representation. The court stated that, in determining whether the difference between the as-represented condition of a company and its actual condition may constitute an MAE, "the court must consider quantitative and qualitative aspects [of the inaccuracies in the representation]."

- ***Quantitative significance of Akorn's regulatory noncompliance***. The quantitative significance of the inaccuracies in Akorn's regulatory compliance representation constituted a "valuation hit" equal to about 21% of Akorn's standalone equity value, the court found. The calculation was based on the parties' respective estimates of the cost of remediation of the problems plus the associated delays in the company's projects pending remediation. The court noted that neither party had presented evidence as to whether remediation costs of that magnitude would be "material when viewed from the longer-term perspective of a reasonable acquiror." It would have been helpful, the court stated, to know the thresholds that companies generally, and that Akorn and Fresenius specifically, use when reporting material events, such as material acquisitions, under Reg. S-K and Item 7 thereof. Absent that information, the Vice Chancellor stated, based on a consideration of a number of imperfect proxies for materiality in this context, which he "weighed against [his] own intuition and experience," he concluded that the 21% decline in valuation was material. The court observed, further, that the record demonstrated that "Akorn pushed Fresenius to pay top dollar for Akorn, extracting every cent that Fresenius was willing to pay." The court stated: "When a deal is priced for perfection, a reasonable acquirer has less ability to accommodate an expense that equates to a substantial portion of the seller's value."

- ***Qualitative significance***. The court found that the inaccuracies in the Regulatory Compliance Representation were also *qualitatively* significant. There was "overwhelming evidence of widespread regulatory violations and pervasive compliance problems at Akorn." The data integrity problems "literally call[ed] into question every released product" of Akorn's. The problems "existed at signing and got worse, rather than better." Compliance with FDA requirements was "no small thing; it is an essential part of Akorn's business" and was "also essential to Fresenius, which cared a great deal about Akorn's pipeline [of new products, the value of which] depended on Akorn's ability to comply with the FDA's regulatory requirements." Akorn's "pervasive data integrity and compliance problems… prevent[ed] Akorn from being able to meet these [requirements]." Rather than being, as it represented at signing, "an FDA-compliant company with accurate and reliable submissions to the FDA based on compliant testing practices," Akorn was "a company in persistent, serious violation of FDA requirements with a disastrous culture of noncompliance." These problems would be expected to have long-lasting effects in terms of "broken trust" with the FDA and the public, the court stated. The court thus found that the regulatory situation was "qualitatively material when viewed from the longer-term perspective of a reasonable acquirer."

Allocation of the risk for "known" inaccuracies in the representations. Akorn argued that Fresenius could not assert an MAE based on regulatory compliance because Fresenius had "accepted the risk" of regulatory noncompliance (*i.e.*, it "knew about the risk of potential [regulatory] issues and signed the Merger Agreement anyway"). In Akorn's view, an MAE qualification to a representation "not only introduces a measure of variance from a flat representation, but also incorporates a broad carve-out for any risks that the buyer may have known about or issues which the buyer identified or could have identified through due diligence." The court disagreed and stated that the MAE qualifier "addresses the degree of deviation [between reality and] the representation that is permissible before the representation would be deemed inaccurate"—but it does not "change the nature of the representation or its risk allocation function." As was the case with the court's consideration of the General MAC (discussed above), the court's firm judgment was that the language of the merger agreement itself determined the allocation of risks between the parties. The Vice Chancellor commented: "If parties wish to carve out anything disclosed in due diligence [or to carve out specific items or issues] from the scope of a representation, then they can do so" by expressly qualifying the representation to exclude those items.

Right to cure failure of a condition by the Outside Date. The agreement required that the acquiror provide the target with an opportunity to cure failure of a condition that was "capable of being cured by the Outside Date." Akorn argued that this provision meant that Fresenius could not terminate the agreement until the Outside Date so long as a breach was "curable in the abstract." The court responded: "But this is not what the Merger Agreement says." The agreement "gives Akorn an opportunity to cure if the failure of a condition is 'capable of being cured by the Outside Date.'" Akorn itself had estimated that the time period needed to remedy the regulatory problems that constituted the MAE would be about three years (which was far beyond the Outside Date).

Covenants Compliance Condition

The Covenants Compliance Condition and the Ordinary Course Covenant. The merger agreement provided that the closing was conditioned on Akorn having "complied with [and] performed in all material respects its obligations" under the agreement. One of Akorn's obligations under the agreement was, between signing and closing, to "use its…commercially reasonable efforts to carry on its business in all material respects in the ordinary course."

"In all material respects" vs. "material breach." The court stated that an "in all material respects" standard is a "different and less onerous" standard than a "material breach." Akorn had argued that compliance with a covenant "in all material respects" means a "material breach" of a covenant such that the breach would, under common law, excuse the counterparty's continuing performance under the agreement. The court wrote that "material breach" is "determined by weighing the consequences [of the breach] in light of the actual custom of men in the performance of contracts similar to the one that is involved in the specific case." Thus, factors that would be considered would include to what extent the injured party would be deprived of what he or she bargained for and could be compensated for that part of the benefit denied, and to what extent the conduct of the party failing to perform comports with standards of good faith and fair dealing. However, the court wrote, in the context of a merger agreement, there is "a different purpose" for the phrase "in all material respects." That purpose is "to eliminate the possibility that an immaterial issue [(*i.e.*, "small, *de minimis*, and nitpicky issues" or issues that do not "significantly alter the total mix of information" provided in the representation)] could enable a party to claim breach or failure of a condition" and thereby "derail an acquisition." Stated differently, in the Vice Chancellor's view, "in all material respects" limited the Covenants Compliance Condition and the Ordinary Course Covenant to issues that were "significant in the context of the parties' contract" even if the breaches were not severe enough to excuse a counterparty's performance under a common law analysis.

"Double materiality." The court noted that the "in all material respects" qualifier appeared in both the Covenants Compliance Condition and the underlying Ordinary Course Covenant, resulting in "two levels of materiality." The Vice Chancellor wrote: "To my mind, the double-materiality standard simply emphasizes that the breach of the Ordinary Course Covenant cannot be immaterial. It has to matter both as a departure from a generic pharmaceutical company's operations in the ordinary course of business and as a deviation from the buyer's reasonable expectations regarding what it would receive at closing."

"Commercially reasonable efforts" vs. "reasonable best efforts." The court (pointing to the Delaware Supreme Court's interpretation in *Williams Cos. v. Energy Transfer Equity, L.P.*) viewed these two standards as functionally equivalent, with both imposing an obligation "to take all reasonable steps to solve problems and consummate the transaction." The court suggested that a "best efforts" commitment may impose a higher standard than these, but noted that Chief Justice Strine, when a Vice Chancellor, "observed that even a 'best efforts' obligation 'is implicitly qualified by a reasonableness test—it cannot mean everything possible under the sun.'"

Ordinary Course of Business Covenant

The Ordinary Course Covenant. The merger agreement required that the target use its commercially reasonable efforts to operate post-signing in the ordinary course of business in all material respects. The merger agreement did not qualify “ordinary course” as relating to another similarly situated company or as relating to Akorn’s past practices. Without commentary on the issue, the court focused on whether Akorn had acted in the ordinary course of “a generic pharmaceutical company.”

Ordinary course of a “generic pharmaceutical company.” The court wrote that “Akorn consciously chose to depart from the ordinary course of business of a generic pharmaceutical company.” It did so, the court stated, by not attempting to redress its serious regulatory compliance issues and by submitting regulatory filings to the FDA based on “fabricated data.” The court emphasized that Akorn did not even conduct its own investigation of the company’s regulatory compliance after two detailed whistleblower letters were received—and instead decided simply to “shadow” Fresenius’s investigation. All of these decisions by Akorn, in the court’s view, were made in an effort to prevent the acquiror from discovering Akorn’s problems.

The failure to operate in the ordinary course was material. “In the context of the merger agreement,” the court wrote, the breaches of the Ordinary Course Covenant “departed from what Fresenius could reasonably expect and changed the calculus of the acquisition for purposes of closing,” the court stated. These breaches after signing “hid problems” from Fresenius and “cost Akorn a year of what could have been meaningful remediation efforts.”

Reasonable Best Efforts to Close Covenant

Commitment to use reasonable best efforts to close. The court viewed the Reasonable Best Efforts to Close commitment as an obligation “to take all reasonable steps to solve problems and consummate the transaction.” In this case, the court wrote: “Akorn’s dismal post-signing performance gave Fresenius good cause to evaluate its rights and obligations under the merger agreement,” and the whistleblower letters subsequently gave it good cause to evaluate whether Akorn’s representations were accurate. Fresenius was “entitled” to consult with counsel and “to evaluate whether [the General MAC Condition] was met.” Importantly, the court wrote, Fresenius “remained committed to fulfilling its obligations under the Merger Agreement if it was not entitled to terminate”; and “at the same time Fresenius was consulting with [counsel about its right to terminate], Fresenius was also working hard to figure out how the deal could still work.” Specifically, Fresenius “communicated directly with Akron about its performance” and, while it “analyzed” and “explored” whether it had a right to terminate the agreement, it continued to communicate with the target to understand the situation and to try to problem-solve, seriously investigated the regulatory problems as it became aware of them, pressed forward with obtaining antitrust clearance, continued with integration planning, and even offered to extend the drop-dead date if the target believed that would facilitate remediation of the problems (an offer that, notably, the target declined).

Acquiror’s Reasonable Access Right

Use of access rights to determine if there were grounds for termination. Akorn asserted that Fresenius had breached the merger agreement provision that granted it reasonable access to Akorn’s information and personnel for the purpose of “seeking to consummate the transaction.” Akorn contended that Fresenius had used the access rights instead to “manufacture grounds for termination” of the agreement. The court stated that it was appropriate for the acquiror to use the information access rights to investigate whether it had grounds for termination. The court stated that a reasonable access provision provides an acquiror with the opportunity to "investigate issues that arise between signing and closing" so that it can confirm the accuracy of representations and to verify the satisfaction of conditions. Vice Chancellor Laster wrote: "I believe that Fresenius acted legitimately and uncovered real problems. I believe that Akorn knew about both the existence and magnitude of these problems and hoped that Fresenius would not get the full story until after the deal closed…. Instead, the investigation caused Fresenius to learn about the pervasive nature of Akorn's compliance and data integrity issues before closing."

Buyer's Hell-Or-High-Water Commitment to Obtain Regulatory Approval

Requesting that the FTC reconsider an unusual position it had taken was not a breach of the hell-or-high-water commitment. The merger agreement contained a so-called hell-or-high-water commitment by Fresenius to obtain antitrust clearance, which required that Fresenius "take all actions necessary" to obtain antitrust clearance (including the divestiture of any assets) and not take any action that would reasonably be expected to delay obtaining antitrust clearance. The court noted that the grant to the acquiror of "sole control over the strategy for securing antitrust approval" (the "Strategy Provision") was "in some tension" with its hell-or-high-water obligations. The court observed that this provision "inherently recognizes that there is no single and obvious answer as to how to pursue antitrust approval and that Fresenius had the power to make those decisions after consulting and cooperating with [Akorn]." After Fresenius proposed to the FTC a divestiture package comprised of certain target assets, the FTC (in what the acquiror considered to be a highly unusual move) requested that Fresenius divest its own assets in the overlapping areas rather than the target's. Akorn argued that Fresenius breached its hell-or-high-water commitment when it asked the FTC to reconsider this request. The court, however, viewed Akorn's request to the FTC as "reasonable and within the gambit of the Strategy Provision."

Temporarily adopting an alternative divestiture strategy (that would have delayed approval for two months) was a technical—but not material—breach. For one week, the acquiror "contemplated a path that could have constituted a material breach of the Hell-or-High-Water Covenant had Fresenius continued to pursue it." That path involved an alternative to the divestiture package that the acquiror had already proposed to, and was under consideration by, the FTC—and it was expected that the alternative would result in a two-month delay in obtaining FTC clearance (which would still be well within the Outside Date). Fresenius ostensibly viewed the alternative as a superior strategy that would involve the sale of only one property and would resolve outstanding FTC objections relating to the already proposed divestiture package. Notably, however, internal Fresenius emails suggested that Fresenius viewed the potential delay as helpful insofar as it would permit Fresenius additional time to evaluate its potential case that there had been an MAE. After one week, Fresenius changed its mind after receiving an unattractive bid for the single property that would be divested under the alternative strategy. The court found that Fresenius had "technically breached" the hell-or-high-water commitment by adopting a strategy that would have delayed receipt of antitrust clearance, but that the breach was not material "because Fresenius changed course in approximately a week" and the short-lived adoption of the alternative strategy was not expected to change the timing of the antitrust clearance.

Practice and Drafting Points

New drafting considerations for merger agreements and other types of corporate contracts. The court's emphasis in *Akorn* on the plain language of the agreement to resolve issues between the parties should stimulate consideration of modifying the drafting of certain standard provisions. The provisions discussed by the court appear not only in merger agreements but also in most other types of corporate contracts, including financing agreements, commercial contracts, investment agreements, and others. Of course, whether a drafting change would be accepted by the counterparty, or even should be raised with the counterparty, will depend on the parties' respective negotiating strategies and leverage and the particular facts and circumstances.

A MAC is whatever the agreement says it is. There is no free-standing definition of a MAC; it is, simply, what the parties set forth in the agreement that it is. One important drafting consideration is whether the closing condition should be that there *has been* a MAC or, alternatively, should be that events or changes have occurred that *reasonably would be expected to lead to* a MAC. The key drafting consideration is the definition of a MAC (*i.e.,* which events or changes would be included, and which would be excluded, from the definition). Parties can, but typically do not want to, define a MAC by setting forth a quantitative bright-line test—such as a decline in EBITDA of at least X% or a loss of value in market capitalization of at least $X. Thus, parties must consider carefully the categories of events or changes, and any specific events or changes, that are to be considered, or that are to be excluded, when determining whether a MAC may have occurred. Particularly given the court's emphasis in *Akorn* on the specific words of the contract, parties should not necessarily rely on "standard" MAC definitions; rather, they should carefully review all of the general and specific risks that may be applicable prior to closing and decide which should be allocated to the target (*i.e.*, expressly included in the MAC definition) and which should be allocated to the acquiror (*i.e.*, expressly excluded from the MAC definition). Parties and their advisors should seek to ensure that the relevant risks have been identified and considered. Counsel should ensure that the wording accurately reflects the parties' intentions with respect to the allocation of risks. Of course, in all cases, whether a counterparty will accept the allocation to it of any particular risk is a matter of negotiation between the parties.

Drafting MAC clauses—industry-wide changes and disproportionate effects. *Akorn* underscores the importance for the target of excluding from the MAC definition changes reflecting industry-wide (rather than company-specific) conditions. The court's discussion also highlights the importance for the acquiror of excepting from that exclusion industry-wide conditions that have a disproportionate effect on the target. Parties may wish to treat separately and specifically certain issues where it might not be readily apparent whether they reflect industry-wide or company-specific conditions (and, if industry-wide, whether they may have a disproportionate effect on the target)—such as, for example, the emergence of new competition or certain regulatory changes. We note that other drafting issues include whether a disproportionate effect on the target would have to be "material" to be considered and whether the comparison should be stated to be with "peer companies" or with a specified list of companies.

Drafting MAC clauses—"known" risks. Based on the court's discussion in *Akorn*, a target should consider seeking to exclude from the MAC definition changes arising from "known" risks—such as new competition or other risks generally known by industry insiders, as well as risks disclosed in due diligence, set forth on schedules to the merger agreement, and/or disclosed in the target's public filings. On the other hand, an acquiror may wish to specify that the MAC definition as written is applicable without regard to whether the factors included or excluded reflect risks that were "known" to the acquiror. In *Akorn*, the court observed (in a footnote) that—in a survey of M&A agreements executed between June 1, 2016 and May 31, 2017, for deals valued at $1 billion or more—28% of the agreements contained an MAE carve-out for developments arising from facts disclosed to the buyer or in public filings.

General exception for items disclosed. A seller may seek a *general* exception to all of the agreement's representations, covenants and/or closing conditions for items or information disclosed on any schedule or exhibit to the agreement, in public filings of the company, in materials provided in the data room, and/or otherwise disclosed to the buyer in writing. If a buyer agrees to this exception, the parties will want to ensure clarity as to whether *post-signing developments* with respect to any categories of (or specific) items or information disclosed would or would not be excluded from the exception.

Establishing an MAE at trial. To establish whether the as-represented condition of a company compared to its actual condition constitutes an MAE, the parties should present evidence as to both quantitative and qualitative factors. With respect to the former, the parties should present evidence indicating whether the quantitative "valuation hit" resulting from the discrepancy is "material" from the point of view of a long-term investor (based on, for example, what valuation criterion the acquiror or others (a) used initially to value the target and/or (b) generally apply to reporting material acquisitions or other changes under Reg. S-K or Item 7 thereof).

MAE in the context of a financial buyer. As noted, the court observed (in a footnote) that commentators have suggested that the requirement of "durational significance" may not apply when evaluating whether a MAC occurred in the context of a buyer who is "a financial investor with an eye to a short-term gain." The court cited a Tennessee Chancery Court decision finding that "two quarters of bad performance would be material to a buyer in a highly leveraged transaction." Accordingly, a financial buyer, in evaluating whether a MAC has occurred, should consider whether (and if appropriate should make the case that) the relevant time period for "durational significance" should be shorter than in the case of a strategic buyer.

Drafting ordinary course of business covenants. The court's discussion in *Akorn* highlights that parties may wish to consider to what extent the ordinary course covenant in the merger agreement requires operation of the business in the ordinary course consistent with the target's own past practices and to what extent it requires operation of the business in the ordinary course that would be expected of a hypothetical similarly situated company. *Akorn* also underscores that parties should consider whether there are any particular actions that should be specified in the agreement as actions that the target must (or need not) take to comply with the ordinary course covenant. A target should consider whether there are events that would arise as to which it would not be readily apparent what the "ordinary course of business" would be—for example, in the case of natural disasters, whistleblower activity, or other kinds of extraordinary events—and whether these should be excluded from the general "ordinary course" requirement.

Drafting an access right. Based on *Akorn*, a target may wish to seek to specify contractual limitations on the scope, timing and use of an access right—for example, stating that the access right can be used only to verify the satisfaction of conditions to the agreement; can be invoked only within a specified short timeframe prior to the closing date; and will be available only to specified persons. On the other hand, an acquiror may wish to seek to specifically confirm that the right is broad in scope—and, for example, includes a right to investigate any issues that arise between signing and closing and a right to use outside counsel and experts in any such investigations.

Drafting efforts obligations. The court suggests in *Akorn* that, without further definition, all efforts standards could, in practice, impose a similar obligation (*i.e.*, to take all reasonable steps to solve problems and consummate the transaction). Parties should consider expressly setting forth (in a disclosure schedule or otherwise) any specific actions that must (or that need not) be taken to meet the efforts standard included in the agreement. Where parties agree on a "best efforts" standard or "hell-or-high-water" commitment, they should consider whether they intend this standard to require even actions that are not "commercially reasonable" (or to reflect the highest possible level of efforts that is judicially sustainable)—and, if so, they should expressly so provide.

Drafting materiality standards. Parties should take into account that the court may view a provision that a representation or covenant shall be true or complied with "in all material respects" as a lower standard for materiality than a provision that any inaccuracies or noncompliance have (or reasonably would be expected to have) an MAE. Parties should also take into account that the court may view a materiality standard in a bring-down condition, together with a materiality standard in the underlying representation or covenant, as the equivalent of just a single level of materiality. If the parties intend otherwise, they should expressly state so. Parties should ensure that, where, as is usual, different materiality standards are utilized in different provisions, the provisions, when read together, accurately reflect the parties' intentions.

Applicability of efforts to close when considering whether there is a right to terminate. An acquiror who is considering whether it has the right to terminate the merger agreement should consider to what extent it may or may not be required to continue with efforts to close the transaction. In *Akorn*, the court emphasized that, even after the acquiror began to evaluate its termination rights, it continued to communicate with the target, to problem-solve, to pursue regulatory approvals, and to proceed with integration planning. We note that the appropriate extent of efforts to close after the possibility of a right to terminate has been identified will depend on the agreement language and the specific facts and circumstances. If an acquiror decides to terminate, the record should reflect that the desire to terminate is not based on general "buyer's remorse" but on specific factors that, under the merger agreement, provide a right of termination.

Regulatory commitment and control of the regulatory strategy. Based on *Akorn*, merger agreement parties may wish to consider increased specificity in provisions granting control to one of the parties of the strategy to obtain regulatory approval. For example, the parties may wish to provide specifically the timeframe for delay that would be impermissible in connection with adopting a new strategy for obtaining regulatory approval.

Drop-dead date and opportunity to cure. *Akorn* serves as a reminder that parties should consider the interrelationship between the drop-dead date and a right of the target to cure condition failures. It should be clearly specified whether the opportunity to cure applies only if the breach is curable by the drop-dead date (in which case a termination right could be exercised by the acquiror *before* the drop-dead date if the breach is not curable) or whether the opportunity to cure is in all cases available to the target until the drop-dead date (in which case a termination right could be exercised by the acquiror only at the drop-dead date).

Termination right subject to the terminating party not being in breach. The right of a party to terminate a merger agreement typically is subject to the party itself not being in breach of the agreement. The standard for that breach should be carefully considered so that a termination right is not defeated unless the breach has a material impact. For example, in *Akorn*, the acquiror could not terminate if it was then in “material breach” of “any” of its covenants or representations in the agreement. This drafting arguably could be viewed as setting a low standard for defeating the acquiror’s right to terminate—that is, that even if a *non*-material covenant were materially breached, the right to terminate would be lost. For a clearly higher standard, consideration should be given to referencing “material breach of a *material* covenant or representation.”