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Contrast In MAC Clauses

Practice in the United States and key European jurisdictions.

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The material adverse change clause, typically granting an acquiring party a right to refuse to complete an M&A transaction if there is a material adverse change at the target prior to closing, is a standard feature in U.S. acquisition agreements. Indeed, the evidence is that the majority of U.S. M&A deals feature a material adverse change, or "MAC," clause or condition.[1] It is understandable, then, that U.S. parties may be surprised at the differences in the market practice and legal framework relating to MAC clauses in Europe. This article provides a general overview of MAC clauses as used in three key European legal systems—England, France and Germany—and highlights contemporary practice and law in those jurisdictions.

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MAC Clauses in the United States

The MAC clause (also referred to as a "material adverse effect" clause) is typically a highly negotiated term in any M&A transaction. MAC clauses in U.S. acquisition agreements tend to lack a "bright-line" test to determine when a MAC has occurred, although recent transactions have exhibited a trend toward more specific criteria, and will typically feature a number of carve-outs and exceptions.

As a result, U.S. practitioners evaluating whether a MAC has occurred face uncertainty. One of the most significant cases to consider this issue was *In re IBP Inc. Shareholders Litigation*, which outlined the elements needed to establish that a MAC had occurred under Delaware law.[2] The Delaware Chancery Court held that a MAC must be a long-term effect rather than a short-term failure to meet a financial target, stating that, "[a MAC] provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner."[3]

The *IBP* holding requires a target to suffer financially over a "commercially reasonable period [of time], which one would think would be measured in years rather than months"[4] before a MAC will be found to have occurred. The court highlighted key factors to consider when evaluating the validity of a MAC assertion: the total mix of information available to the bidder at the time it executes a merger agreement, the construction of the MAC clause itself, the allocation of risk that the bidder wishes to have assigned to the target, and the presence of any contradictory or inconsistent circumstances that could potentially negate the MAC agreement altogether.[5]

The challenging deal conditions of the past few years spawned several high-profile MAC cases including, notably, *Genesco Inc. v. The Finish Line Inc.* (finding that a MAC clause would have existed but for a carve-out that applied)[6] and *Hexion Specialty Chemicals Inc. v. Huntsman Corp.* (in which the Delaware Chancery Court noted that "Delaware courts have never found a [MAC] to have occurred in the context of a merger agreement").[7]

In the public M&A context, securities laws, broadly speaking, do not impinge on the use

of MAC clauses. However, the SEC has taken the position that a MAC condition must be defined with sufficient clarity and specificity so as to enable "shareholders to determine if the condition has been triggered."[8]

The MAC Clause Under English Law

In transactions governed by English law, the use of a MAC closing condition is hardly unheard of, but is less commonly used than in U.S. transactions. Accordingly, a practitioner negotiating the acquisition of an English target is much more likely to encounter resistance to the inclusion of a MAC clause than would be the case with a U.S. target. While this disparity is in part due to the fact that it is effectively impossible to invoke a MAC clause in the acquisition of a public target (explained in further detail below), it is still indicative of relative animosity toward the concept of the MAC clause itself.

In addition, practitioners should be aware that market practice in England trends toward either not defining a MAC or defining it in a relatively simple manner, without the same degree of exceptions and carve-outs to exceptions as is the practice in the United States. In contrast to the practice in the United States, many practitioners are content with the courts' standard of what constitutes a MAC.

In the United Kingdom, the termination of public combination transactions is subject to the City Code on Takeovers and Mergers and the scrutiny of the Panel on Takeovers and Mergers. The Panel considers both parties' complaints and renders judgment that contemplates public policy considerations relating to acquisitions and offers. Known for its efficient and speedy resolution of disputes, the Panel is hardly acquiror-friendly in the context of MAC closing conditions.

Though the approach to MAC evaluation may vary, the United States and the United Kingdom are seemingly equally strict. Much like IBP, the attempt of WPP Group PLC to withdraw its offer to purchase Tempus Group PLC in 2001 and the ensuing litigation laid the foundation for the contemporary MAC standard in the United Kingdom.[9] Due to the turbulent economic landscape following the Sept. 11 attacks, WPP asserted that a MAC had occurred with respect to its pending acquisition of Tempus.

The Panel ruled that a MAC had not occurred and provided guidance as to when a MAC clause could be properly asserted. Notably, the Panel stated that detrimental circumstances of material significance to the bidder in the context of the offer would have to exist for a MAC to have occurred. The Panel cited a 1974 statement issued during similar economic conditions and reaffirmed its historically reluctant attitude toward permitting the withdrawal of a takeover offer.[10]

Changes in political, industrial or economic circumstances consequently are not normally adequate grounds to assert the occurrence of a MAC.[11] The Panel also underscored the high threshold required to enable a MAC condition to be invoked, which requires "[an] adverse change of very considerable significance striking at the heart of the purpose of the transaction in question."[12] While the Panel stated that the test does not require a bidder to demonstrate frustration of contract in the legal sense, the threshold is nevertheless a very high one.[13] The Panel applied this high standard and did not allow WPP to withdraw its offer to acquire Tempus, reinforcing the Panel's emphasis on an offeror's original commitment to purchase a publicly traded target.

The MAC Clause in France

French M&A transactions also tend to include MAC closing conditions less frequently than their U.S. counterparts.

The validity of a MAC clause under French law is enshrined in principles of freedom of contract, and the use of MAC closing conditions in acquisition documents relating to a French private target is on the rise. However, practitioners might theoretically have less freedom with respect to the terms of a MAC clause in France, because there is arguably a greater degree of risk that, if not properly drafted, a court would invalidate a MAC clause. Pursuant to Article 1174 of the French Civil Code, a contractual condition is void when the party benefiting from the condition has unilateral power to influence its occurrence.

Among other factors, this may help to explain some of the differences in market practice between U.S. and French MAC clauses. MAC clauses in acquisition agreements relating to French targets tend to make reference to the occurrence of very specific events and often include thresholds against which to objectively measure the occurrence of a MAC, as opposed to the less defined terms found in acquisition agreements relating to U.S. targets.

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Public M&A practitioners should be aware that a MAC condition is not allowed in the context of an offre publique d'achat (the French equivalent of a tender offer) concerning a French target listed in France. The Autorité des marchés financiers, the French equivalent of the Securities and Exchange Commission, oversees all tender offers for a French target listed in France and does not allow bidders to include a MAC condition in such offers. In addition, generally speaking, an acquiror who purchases in excess of one-third of the shares or voting rights of a French target listed in France must, by law, make an offer for all remaining shares of such target and may not include a MAC condition in such offer.[14]

Unfortunately, there is little French case law relating to MAC clauses. In one of the few cases addressing the issue, the Paris Court of Appeals rejected a plaintiff's request to avoid closing an acquisition where the target's liabilities had increased significantly between signing and closing.[15] While the court ultimately decided the case on the grounds that the increase in liabilities did not meet the threshold specified in the MAC clause itself (8.5 percent of the purchase

price), the court also noted that the acquiror had been provided sufficient due diligence materials so as to foresee the increase in liabilities. Much like the court in *IBP*, the Paris Court of Appeals went beyond the contractual language itself in reaching its decision, but the decision provides inchoate guidance to the practitioner.[16]

The MAC Clause in Germany

The use of MAC clauses in Germany is, as in England and France, far less common than in the United States. MAC clauses are more prevalent in private equity transactions than in others, and even this use of the MAC clause had been waning until the beginnings of the recent global financial crisis. While the use of MAC clauses in Germany is again on the rise, practitioners should be aware that they are still likely to encounter resistance to the inclusion of a MAC clause in transactions other than private equity transactions.

While generally permitted in the context of private M&A transactions, the use of a MAC clause in the acquisition of a public German target[17] is subject to a number of considerations. In the context of a Freiwilliges Übernahmeangebot, or voluntary offer, MAC clauses are permissible but subject to several important restrictions. First, the offer must not be subject to conditions that can be triggered by the bidder.[18] Second, any conditions must be drafted in a clear and precise manner to enable shareholders to determine whether the conditions have been met.[19] Third, the triggering event must be particularly significant. While it is unclear what level of significance is required, commentators argue that the triggering event must come close to frustration of contract.[20]

The Bundesanstalt für Finanzdienstleistungsaufsicht, or BaFin, is the German securities regulator that reviews all public purchase or exchange offers. BaFin traditionally did not allow MAC clauses in any public M&A transaction but now accepts MAC clauses to the extent they comply with the conditions set forth above. Practitioners should be aware that BaFin will not permit a decline in the target's share price to be a triggering event in a MAC clause, as BaFin is of the view that a bidder can influence the target's share price.[21] However, BaFin is open to allowing decreases in a particular stock index to trigger a MAC clause.[22]

A special rule exists in the context of a Pflichtangebot, or mandatory bid. Any investor who exceeds the mandatory bid threshold (acquires in excess of 30 percent of a German target outside of a voluntary offer) is deemed to control such target and must, by law, make an offer for all remaining shares of such target.[23] Since a mandatory bid must be unconditional, a MAC condition is not permitted.

The construction of a German MAC clause may also differ from the terms of a U.S. MAC clause. Private transactions may include a "two-step MAC" with two triggers—the first allowing the acquiror to seek a purchase price adjustment and the second allowing the acquiror to walk away from the deal. In private transactions, some commentators advocate the use of arbitration to determine the occurrence of a MAC.[24] In addition, as is the practice in France, German MAC clauses tend to be far less subjective and often make reference to the occurrence of specific criteria (e.g., a decrease in the DAX of more than 1,200 points over a specified period or a numerically specified impact on the target).

Conclusion

While there are distinct differences in market practice and regulation with respect to MAC clauses in the jurisdictions discussed in this article, the use of MAC clauses in European M&A agreements is on the rise. A MAC clause can, in the right cases, provide a party acquiring a European target with protection from the risk of a target's deterioration. The authors hope this article proves useful to the practitioner in determining when a MAC clause should be sought.

1. See, e.g., 2009 Private Target Study Working Group, 2009 Private Target Mergers & Acquisitions Deal Points Study, 2009 A.B.A. SEC. BUS. L. REP. 66.

2. *In re IBP Inc. Shareholders Litigation*, 789 A.2d 14 (Del. Ch. 2001).

3. Id. at 68.

4. Id. at 67.

5. Id. at 63-71.

6. *Genesco Inc. v. The Finish Line Inc.*, Case No. 07-2137-II(III) at 3 (Tenn. Ch. Dec. 27, 2007).

7. *Hexion Specialty Chemicals Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008).

8. The Royal Bank of Scotland Group plc, SEC Comment Letter, http://sec.gov/Archives/edgar/data/844150/000104746907006817/filename1.htm (Sept. 4, 2007) (last visited Oct. 5, 2010).

9. See U.K. Takeover Panel Statement, Nov. 6, 2001, http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/2001-15.pdf.

10. Id.

11. Id.

12. Id.

13. U.K. Takeover Panel Statement, April 28, 2004, http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/ps05.pdf.

14. AMF, Règlement Général de l'Autorité des Marchés Financiers, art. 234-2.

15. Cour d'appel [CA] [regional court of appeal] Paris, 3e ch., May 24, 2005, R.G. 2004, A, 865.

16. See Thierry Gontard & Nadia Nevzi, Les aspects corporate, REVUE LAMY DROIT CIVIL, July-August 2009, at 59.

17. For the purpose of this article, German target means any target with its legal seat in Germany or in another signatory to the Agreement on the European Economic Area that is listed on an organized market within the meaning of the Wertpapiererwerbs- und Übernahmegesetz, §2, paragraph 7.

18. Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], 2001, §18, para. 1 [F.R.G.].

19. Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], 2001, §11 [F.R.G.].

20. See Kai Hasselbach, in KÖLNER KOMMENTAR ZUM WPÜG §18, n. 62 (Heribert Hirte et al. eds., 2010).

21. Kai Hasselbach & Johannes Wirtz, Die Verwendung von MAC-Klauseln in Angeboten nach dem WpÜG, BETRIEBSBERATER 842, 844 (2005).

22. Kai Hasselbach, in KÖLNER KOMMENTAR ZUM WPÜG §18, n. 64 (Heribert Hirte et al. eds., 2010).

23. Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], 2001, §35 [F.R.G.].

24. See Christian Borris, Streiterledigung bei (MAC-) Klauseln in Unternehmenskaufverträgen: ein Fall für "Fast-Track"-Schiedsverfahren, BETRIEBSBERATER 294 (2008).