Material Adverse Change Clauses
Increasingly Scrutinized After September 11

The events and aftermath of September 11 are influencing the ways in which mergers and acquisitions (M&A) professionals negotiate and document deals. Since September 11, M&A professionals have been paying particular attention to the language of material adverse change (MAC) clauses. Generally MAC language delineates the triggers for an acquiring company to terminate a deal (or, practically speaking, renegotiate the price) if a MAC occurs in the target company or its business between the date that the agreement is signed and the date of closing. In June 2001, the Delaware Chancery Court refused to allow Tyson Foods Inc., the country’s largest poultry producer, to invoke a MAC clause to void its acquisition of IBP Inc., demonstrating the difficulties involved in enforcing MAC clauses in court.

The Use of MAC Clauses After September 11

In the post-September 11 environment, deal lawyers have attempted to use MACs in a variety of ways. For example, some who entered into a merger agreement before that date have attempted to invoke the MAC clause to end the merger. USA Networks Inc. attempted to terminate its $1.5 billion acquisition of National Leisure Group Inc. by arguing that the events of September 11 and its aftermath could reasonably be expected to have a negative impact on the travel company’s business. In the lawsuit filed in the Delaware Chancery Court to enforce the termination, USA Networks alleged that the attacks on the World Trade Center and Pentagon constituted a material adverse effect because they caused a substantial decline in travel. Furthermore, USA Networks argued that National Leisure’s loss of a material customer constituted a MAC change in the target company’s business.

Although this case provided the court with an opportunity to interpret a MAC clause in the post-September 11 environment, the parties settled in late October. USA Networks agreed to invest $20 million in National Leisure and to name the travel company as the preferred provider of cruise and vacation packages to USA Network’s new travel cable channel.

MAC clauses can also provide an out for underwriters when trading on major stock exchanges is interrupted or ceases for a period of time. The week after the terrorist attacks, Warren Buffett’s Berkshire Hathaway Inc. backed out of an agreement to purchase $500 million in notes of Finova Group Inc., stating that the note offer allowed termination if the markets were closed during the offering period.

Similarly, in the post-September 11 deal between Burlington Resources Inc. and Canadian Hunter Exploration Ltd., the parties agreed that Burlington, the acquiring company, could withdraw its offer and terminate the merger agreement if the financial markets closed for ten days. In other deals that were struck after September 11, some bidders drafted provisions that reduced an...
acquirer’s ability to terminate a deal unless conditions worsened. For example, Reliant Resources Inc. and Orion Power Holdings Inc. agreed, approximately two weeks after the attacks, that changes in the power markets, electric transmission or distributions markets, financial or securities markets, or the economy in general, would not qualify as a material adverse effect except to the extent that such changes were caused “by a material worsening of current conditions caused by acts of terrorism or war (whether or not declared) occurring after the date of [the] Agreement.”

Some acquirers have specifically exempted negative business consequences from the terrorist attacks as qualifying as a MAC. Parties remain bound to the agreement despite the possible negative financial consequences resulting from the terrorist attacks. In one deal the parties amended their merger agreement so that that the deal could not be terminated because of “the terrorist attacks on the United States on September 11, 2001 and any subsequent military actions and other armed hostilities, including additional terrorist attacks on the United States or any military response by the United States, resulting therefrom (other than any such subsequent actions or hostilities that will, because of their significant and lasting effect on the United States and/or its economy, make the consummation of the offer impracticable).” Some acquirers may make a deal terminable because of additional terrorist attacks or responses.

Most interestingly, the Dynergy/Enron merger agreement did not specifically provide for September 11 carveouts, but Dynergy noted a MAC in its announcement terminating their deal. This case will probably provide a Texas judge with the opportunity to examine the contours of MAC.

**Recommendations**

It goes without saying that every target company and, therefore, every deal is different. Each company is affected differently by a variety of economic and business factors. But professionals can assist their clients in carefully thinking through, and drafting for, likely occurrences that may make it more likely that a MAC clause will be triggered or enforced. How specifically have the events of September 11 and their aftermath affected the target company, its business and its prospects? One could assume that these effects are already figured into the pricing of any post-September 11 deal.

Clauses that identify general economic conditions or general industry conditions will not likely be invoked. Therefore, a buyer might consider adding specifically defined MAC language such as a decrease in a particular market or business, a loss of certain customers or employees, or the cessation of trade on the major stock markets for a specified period of time that specifically result from terrorist attacks, acts of war or anthrax outbreaks or scares. Such language might provide more protection if the buyer decides to cancel a deal.

Sellers may consider limiting the definition of material adverse effects to those that result from “continuing acts of terrorism,” creating an exception for the negative economic effects on business that result from the September 11 attacks, or not adding language regarding acts of terrorism to the MAC clause altogether.
We Can Help

The Katten Muchin Zavis Rosenman Mergers and Acquisitions Practice represents public and private companies in transactions across diverse industries, domestically and across international boundaries, in friendly or hostile contexts. We will continue to monitor developments in MAC clauses and will provide additional guidance as changes occur. For further information, please contact the practice Co-Chairs:

David H. Landau  Wayne A. Wald
212.940.6608    212.940.8508
david.landau@kmzr.com  wayne.wald@kmzr.com